No. 11002

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

PEOPLES BANK,

*Plaintiff,*

*against*

FEDERAL RESERVE BANK OF SAN FRANCISCO, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM and HENRY F. GRADY, Federal Reserve Agent,

*Defendants.*

## BRIEF FOR PLAINTIFF-APPELLANT.

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# United States Circuit Court of Appeals

For the Ninth Circuit.

Peoples Bank,
Plaintiff,

*against*

Federal Reserve Bank of San Francisco, Board of Governors of the Federal Reserve System and Henry F. Grady, Federal Reserve Agent,
Defendants.

## BRIEF FOR PLAINTIFF-APPELLANT.

This is an appeal by the Peoples Bank from portions of an order of the District Court for the Northern District of California, Southern Division, entered November 17, 1944, in so far as the order, among other things, granted the motion of the defendant, Federal Reserve Bank, to dismiss the complaint, and granted the motion of Henry F. Grady, Federal Reserve Agent, to dismiss the complaint against him and dismissed the complaint (R., pp. 165, 166, 148). The said order also granted the motion of the Board of Governors of the Federal Reserve System to dismiss the complaint against it; but no appeal has been taken from this order. Said order also granted the motion of the defendant Federal Reserve Bank for an order dismissing the motion of the plaintiff for a summary judgment. No appeal has been taken from that order. The only question before the Court on the appeal of the plaintiff is whether the complaint was properly dismissed as to the Federal Reserve Bank and the Federal Reserve Agent.

The said order also denied the motion of the Reserve Bank for a summary judgment; and the Reserve Bank has appealed from this denial.

## Statement.

By its complaint, the plaintiff, pursuant to the provisions of Sec. 400 of Title 28, U.S.C.A., seeks a declaratory judgment to the effect that condition No. 4 (see p. 3, *infra*) attached to its permit to acquire stock in the defendant Reserve Bank, is invalid. The prayer of the complaint also asks for a temporary and a permanent injunction, but these are incidental measures of relief which, presumably, will not need to be invoked. The case should be viewed as a simple suit for a declaratory judgment. The matter came before the District Court on the motions of the three defendants to dismiss the complaint (all of which motions were granted), and on the motion of the Reserve Bank for a summary judgment, which was denied.

The defendant Board of Governors of the Federal Reserve System (sometimes hereinafter referred to as the Board) moved to dismiss the complaint on the ground that jurisdiction had not been obtained over it, inasmuch as, according to its claim, it was an "inhabitant" of the District of Columbia, and consequently could not be sued in the United States District Courts of California. Since no appeal is taken by the plaintiff-appellant from the order of the Court dismissing the complaint as to the Board of Governors, and since, as we shall herein contend, the Board of Governors is not an indispensable party, the plaintiff-appellant proposes to proceed against the remaining parties under the provisions of Section 50 of the Judicial Code, 28 U.S.C.A. Sec. 111.

*Jurisdiction.* The jurisdiction of the District Court was based on Secs. 1 and 8 of Article 1 and the Fifth Amendment to the Constitution, and under Sec. 9 of the Federal Reserve Act, as amended (12 U. S. C. A., 321-338, inc.); Secs. 24 (1)(4) and 274d of the Judicial Code (28 U. S. C. A., 41, 400 and Sec. 25(b) of the Federal Reserve Act, as amended (see Pars. I and II of the Complaint, R., p. 3). The jurisdiction of this Court is based on 28 U. S. C. A., Sec. 225(a) and (d).

The complaint (R., pp. 3-11) alleges that the plaintiff is a California state bank and a member of the Federal Reserve System; that the defendant Federal Reserve Bank is the Federal Reserve Bank in the 12th Reserve District, having its office in San Francisco, and that the defendant Henry F. Grady is Chairman of the Board of that bank and is the Federal Reserve Agent located at that bank. That on November 28, 1941, the plaintiff, then being desirous of becoming a member of the Federal Reserve System, made application to the Board of Governors of the Federal Reserve System, under the applicable rules and regulations of the Board, for the right to subscribe to the stock of the defendant Reserve Bank, and that on May 6, 1942, the Board of Governors granted this application, subject to certain conditions, among which was the following:

> "4. If, without prior written approval of the Board of Governors of the Federal Reserve System, Transamerica Corporation or any unit of the Transamerica group, including Bank of American National Trust and Savings Association, or any holding company affiliate or any subsidiary thereof, acquires, directly or indirectly, through the mechanism of extension of loans for the purpose of acquiring bank stock, or in any other manner, any interest in such bank, other than such as may arise out of usual correspondent bank relationships, such bank, within 60 days after written notice from the Board of Governors of the Federal Reserve System, shall withdraw from membership in the Federal Reserve System."

The complaint then alleges (Paragraph V) that thereafter and on May 7, 1942 the *defendant Reserve Bank** "informed the plaintiff that as a condition to its subscribing to the stock of the defendant, Federal Reserve Bank of San Francisco, *it would be required by said Bank* to accept the said condition No. 4 and to agree to comply with the same and all thereof, said acceptance of said agreement to be evidenced by a resolution of its board of directors."

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* Italics in this brief ours, unless otherwise noted.

Thereafter, on May 12, 1942, the plaintiff being desirous of acquiring the said stock in the defendant Reserve Bank and becoming a member of the Federal Reserve System "and under the compulsion of the said requirement of said defendant, did, by resolution of its board of directors, accept the said condition No. 4, and agreed to comply with the same". That thereafter, 34 shares of the capital stock of the defendant Bank were paid for by and were issued to the plaintiff, and that the plaintiff is now the owner of said shares.

The complaint then alleges (Paragraph VI) that on February 17, 1944, without the assistance or prior knowledge of the plaintiff, said Transamerica Corporation became the owner of 500 shares out of the 5,000 shares of the capital stock of the plaintiff, which 500 shares have been transferred into the name of and issued to said Transamerica Corporation; and, on information and belief, that the acquisition of said shares was made without the written approval of the Board of Governors of the Federal Reserve System, and falls within the purview of condition No. 4.

The complaint then alleges that on April 4, 1944, the plaintiff notified the Board of Governors of said acquisition of stock by Transamerica and goes on to state as follows:

"VIII.

> "Defendants assert and contend that said condition No. 4 is in all respects valid and enforceable against the plaintiff and empowers the defendant, Federal Reserve Bank of San Francisco, to cancel the shares of said bank owned by plaintiff and to terminate plaintiff's membership in the Federal Reserve System; upon information and belief, plaintiff alleges that defendants intend to and will, unless restrained, take proceedings, predicated on said condition No. 4, designed to deprive plaintiff of its ownership of said shares of defendant, Federal Reserve Bank of San Francisco, and of membership in the Federal Reserve System, and of all the benefits thereof, to the great and irreparable injury and damage of plaintiff, and that such proceedings are imminent.

> "Plaintiff on the contrary asserts that the requirement by defendants, that as a condition precedent to the acquisition of stock of defendant, the Federal Reserve Bank of San Francisco, plaintiff should accept the said condition 4 and agree to comply therewith, is in all respects without authority in law, and is unreasonable, arbitrary, capricious and discriminatory, and is invalid, null and void.
>
> "Plaintiff further asserts that defendants, or any of them, have no power or authority to take any proceedings predicated on said condition No. 4, designed to deprive plaintiff of its ownership of shares of the defendant, the Federal Reserve Bank of San Francisco, and of membership by the plaintiff in the Federal Reserve System; plaintiff further asserts that said void condition No. 4 is a cloud upon the title to the said shares of defendant, the Federal Reserve Bank of San Francisco, owned by plaintiff."

The complaint then alleges (Paragraph IX) that "by reason of the premises there exists between the parties to this action an actual, justiciable controversy within the purview of the Federal Declaratory Judgment Act" and that the "plaintiff is entitled to have its rights adjudged and declared in this action".

The complaint alleges generally that the said condition No. 4 is invalid, null and void (Paragraph IV).

As above stated, the principal prayer of the complaint is that the Court adjudge "the rights and legal relationships of the plaintiff and the defendants in the premises" and declare that said condition No. 4 is unauthorized by law and beyond the power of the defendants or any of them to impose, and is invalid, null and void.

**Specification of Errors of District Court.**

The District Court bases its decision as respects the motion of the defendant Reserve Bank on four grounds (R. p. 149):

> 1. That the Board of Governors is an indispensable party over which the District Court has no jurisdiction;

2. That no justiciable controversy, in a legal sense, exists between the plaintiff and the Reserve Bank.

3. That in view of the fact that the Board of Governors had not yet taken any action to enforce condition No. 4, the suit was premature;

4. That a case was not made out by the complaint for the removal of an adverse claim or cloud on title under the provisions of Section 738 of the Code of Civil Procedure of California.

The District Court bases its decision as respects the motion of the defendant Grady on two grounds (R. p. 155):

1. That the Board of Governors is an indispensable party; and

2. That there is no justiciable controversy between the Reserve Agent and the plaintiff.

In all of the foregoing determinations, we respectfully submit that the District Court was in error.

**What Constitutes the Federal Reserve System.**

Title 12, of the United States Code concerns "Banks and Banking". Chapter 3 of Title 12 deals with the "Federal Reserve System". The "Federal Reserve System," so-called, is composed of the following:

*A. The Board of Governors of the Federal Reserve System.* This is an administrative board (Sec. 241, Title 12) having "Enumerated Powers" (Sec. 248, Title 12), but no grant of any general authority.

*B. The Federal Reserve Banks.* There are twelve federal reserve banks, one for each federal reserve district. The federal reserve banks are straight-out corporations, having the power to adopt a seal, make contracts, to sue and be sued, complain and defend in any court of law or equity. Each reserve bank is given the power:—"to exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of

this chapter, and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this chapter'' (Sec. 341, Title 12). Each reserve bank can be sued only in the district of its location *Bacon* v. *Federal Reserve Bank of San Francisco,* 289 Fed. 513.

*C. Member Banks,* of which there are two kinds: (1) national banks and (2) state banks. In order to be a ''member bank'', the national bank and the state bank must become stockholders of the reserve bank for the district in which they are located. *Such stock ownership is the sole qualification.*

It is compulsory for national banks to become stockholders of the federal reserve bank of their respective districts (Sec. 282, Title 12). *The Board of Governors has nothing to say about it, irrespective of whether any of the stock of the national bank is held by any other corporation whatsoever.* State banks become member banks only of their own volition. Before a state bank can become a stockholder of its local reserve bank, it must apply to the Board for a permit to acquire the stock. Its eligibility is governed by the statutes (Sec. 321, Title 12).

*Holding Company Affiliates.* The statute has elaborate provisions with respect to ''affiliates'' of member banks, including ''holding company affiliates''. These constitute, in general, companies which own either a majority of the shares of capital stock of a member bank or more than 50% of the number of shares voted for the election of directors of any one bank at the preceding election, or which control in some manner the election of a majority of the directors of any one bank. (Sec. 221(a), Title 12.) The right to vote its stock in a member bank held by a holding company affiliate is subject to the obtaining of permission from the Board of Governors of the Federal Reserve System. *There are no restrictions in the banking law or otherwise upon the unqualified right of a holding company to acquire stock in a state bank, either a member bank or a non-member bank.* Such holding company affiliates are under limited examination and supervision of the Board, but they are

not, in a strict sense, embraced within the Federal Reserve System.

*D. Federal Reserve Agent.* The statute provides that one of the Class C directors of a reserve bank (all of which Class C directors shall be appointed by the Board) shall be designated as Chairman of the board of directors of the Federal Reserve Bank, and as "Federal Reserve Agent", and that "in addition to his duties as chairman of the board of directors of the Federal Reserve Bank he shall *be required to maintain, * * * a local office of said Board on the premises of the Federal Reserve Bank.* He shall make regular reports to the Board of Governors of the Federal Reserve System and *shall act as its official representative for the performance of the functions conferred upon it by this chapter"* (Sec. 305, Title 12).

## Summary of Argument.

**I. Condition No. 4 is invalid, because it is without warrant or authority in law. The condition is not only not authorized by the statute but is in direct contravention of many statutory provisions. The invalidity of condition No. 4 does not arise from any abuse of discretion, but arises from a total lack of authority in the Board to impose it.**

**II. The condition is invalid because arbitrary, unreasonable, unjust and discriminatory.**

**III. The condition is unconstitutional.**

**IV. The Board of Governors is not an indispensable party.**

This is simply a case where a governmental agency, the Reserve Bank (which asserts that it is a mere subordinate), threatens to take action against the plaintiff in the attempted enforcement of an invalid special regulation which neither the superior nor the inferior agency had any authority whatsoever to impose. Under those circumstances the superior is not a necessary party to a suit

against the subordinate. Every person who attempts or threatens to enforce the invalid regulation is a wrongdoer who can be sued separately for his own wrong. He is a trespasser.

**V. There is a "justiciable controversy", within the meaning of the Declaratory Judgment Statute (Sec. 400 of Tit. 28), between the plaintiff and the Reserve Bank.**

The defendant Reserve Bank has many important steps to take in any effective enforcement of Condition No. 4, and it intends to take these steps. A justiciable controversy is clearly alleged in the complaint. In the District Court, the Reserve Bank contended that it had no power under the law to impose conditions and no power to enforce Condition No. 4, and that as a matter of fact it had nothing to do with the imposition of the condition and did not intend to have anything to do with the enforcement of the condition. Obviously the contention that, in fact, it had nothing to do with the imposition or the enforcement of the condition is not open to it on the motion to dismiss, in view of the allegations of the complaint. Further, the contention is not in accordance with the realities. In the very nature of the situation the condition itself requires severance by the Reserve Bank of corporate relations between the plaintiff and the defendant bank—a corporate act.

**VI. This suit, as a suit for a declaratory judgment, is timely. On the admitted allegations of the complaint, proceedings to enforce Condition No. 4 "are imminent".**

Further, a suit for a declaratory judgment is an appropriate proceeding in which a party confronted by a governmental imposition which he believes to be invalid may have a present ascertainment of his rights as a guide to his future conduct. The complaining party in such a proceeding does not have to show that he is threatened with the imminent enforcement of the invalid regulation or condition, nor does he have to allege or show that he would suffer irreparable damage therefrom (as he would have to do in an injunction suit). Nor does he have to sit around with a sword of

Damocles hanging over his head, awaiting the pleasure of the governmental agency as to when, if ever, it will seek to enforce the condition. In view of the acquisition of stock in the plaintiff by Transamerica, the existence of this condition No. 4 is, at present, very detrimental to plaintiff's status and business. It is of great practical importance to the plaintiff to know, right now, where it stands.

**VII. The claim of the Board of Governors and of the defendant Reserve Bank of a right to deprive the plaintiff of its stock in the defendant Reserve Bank by an enforcement of Condition No. 4 is an adverse claim within the purview of Section 738 of the Code of Civil Procedure of California, the existence of which adverse claim the Federal Court in this case can ascertain and declare in a declaratory judgment proceeding.**

This is an additional and sufficient ground for giving relief to the plaintiff. The reasons given by the District Court for deciding against plaintiff-appellant on this point are, we respectfully submit, without merit. *No contention can be made that a proceeding to "determine" an adverse claim is premature.* A plaintiff confronted with an adverse claim to his property is entitled to have it determined at any time, irrespective of whether he is confronted with any threat of action, immediate or otherwise, by the holder of the adverse claim. The facts are *now present* upon which the purported right to terminate the plaintiff's property right may be exercised.

**VIII. Henry F. Grady, as Federal Reserve Agent, is a proper although not an indispensable party defendant.**

## Some Preliminary Observations.

The case arises out of the following circumstances:

The plaintiff bank, as a newly incorporated state bank, desired to begin its business as a member of the Federal Reserve System. This would entitle it to insurance of its

deposits under the deposit insurance provisions of the Federal Reserve Act. To be a member bank, the sole requirement of the law was that it should become a stockholder of the defendant reserve bank. In order to become such stockholder, it had to obtain a permit therefor from the Board of Governors of the Reserve System. It applied for such a permit and was found to be fully qualified from every standpoint, and the permit was granted. The Board of Governors apparently having adopted a policy (for which there was no warrant in law) of limiting the acquisition by Transamerica of further bank stocks, sought to accomplish this limitation by the strange invention of Condition No. 4. This condition provides that if a single stockholder of the plaintiff bank sells one of its shares of stock to Transamerica then the bank loses its right of membership in the System and its status as an insured bank. The expansion of Transamerica is not prevented because it continues to hold the stock it bought. Nevertheless, the plaintiff bank is penalized for something over which it had no control and which had nothing to do with its soundness as a bank or the propriety of its membership in the system.

Plaintiff is a stockholder in the defendant Reserve Bank. Condition No. 4 most seriously and detrimentally affects its ownership of that stock and plaintiff's relationship to the Reserve Bank as a holder of that stock. The suit is simply a suit to determine the validity of condition No. 4 as affecting the plaintiff's ownership of that stock. The controversy is between a stockholder and his corporation.

A mere reading of this condition shocks one's sense of propriety. Can it be possible for plaintiff bank to lose its valuable membership in the Federal Reserve System and its practically indispensable status as an insured bank (both of which would follow from the enforcement of the condition) because, without its knowledge and without any power on its part to control the transaction, one of its stockholders sold a small block of stock to Transamerica? The condition likewise would become operative even if one small stockholder of the plaintiff should obtain a loan on his stock from the Bank of America. The loan may have been obtained

from a branch of the Bank of America whose officers knew nothing of the condition, and the stockholder himself may not have known of the condition.

A "mere reading" of the condition shows that it *is a clear case of unauthorized and arbitrary special regulation,* a regulation that is manifestly in direct conflict with express legislation. To make it was a species of petty tyranny. It is plainly an attempt to do by indirection and trick, that which the Board admittedly could not do directly; to wit, limit the acquisition by Transamerica of bank stock.

There are approximately 2750 state banks that are members of the Federal Reserve System. Our assertion in the District Court that no other state bank has been subjected to any condition faintly resembling condition No. 4 was not challenged. *The plaintiff bank has been singled out as the only bank that may lose its membership in the Federal Reserve System and its status as an insured bank, because one of its stockholders, over whom it has no control, may sell a share of its stock to a particular holding company.* The shares could, with propriety, have been sold to a felon or a professional gambler but not, it seems, to a regulated holding company.

It is obvious that, in condition No. 4, we do not have to do with any attempted regulation of a small bank in Lakewood Village, designed to insure that the bank shall be a sound bank, and shall conduct its business according to sound practices. Condition No. 4 is designed solely to prohibit any extension of the banking interests of Transamerica Corporation. This is a matter as to which the plaintiff bank, as a bank and as a member of the Federal Reserve System, has no control and no self-interest and the defendants no power. Though absurd and futile on its face, because the Board cannot prevent such acquisition even in a single bank, the validity of the condition must, nevertheless, be examined in the light of this manifest objective and the utter lack of legislative authority to achieve it.

An outrageous feature of condition No. 4 is that the plaintiff bank has no control whatsoever over the ful-

fillment thereof. The stockholders of the plaintiff bank have an absolute right to sell their stock to whomsoever they please, including Transamerica, and to do so without the knowledge or consent of the plaintiff, and without obtaining the permission of any public agency. That is what has happened in this case and yet under this condition all of the other stockholders and the depositors of the bank are put in jeopardy of the bank's losing its position as a member of the Federal Reserve System and its status as an insured bank, although the bank may continue to be one of the safest and soundest banks in the country. Meanwhile, Transamerica may have purchased a million shares in other banks without jeopardizing the membership or insurance of any of them.

Under the decision of the District Court, the plaintiff, at the present time, is remediless. It must remain for months or for years under the cloud of this condition No. 4 without knowing whether the present Board or any successor Board is going to seek to enforce it, and yet without means to determine what its rights are until confronted with an actual attempt at enforcement. Even then, according to the District Court, it cannot have its rights with respect to its stock in the defendant bank determined in a suit against the defendant bank in its home jurisdiction of California, but must be put to the trouble and expense of suing the Board of Governors in the District of Columbia. This, we submit, is not the law, and constitutes a travesty on justice.

As we hereinafter show (*infra* p. 56 *et seq.*), *a present determination of the validity or invalidity of condition No. 4 is of the utmost practical importance to the plaintiff bank.* We are not involved in this case in an academic discussion of theoretical rights.

The defendants, in the Court below, refused to deal with the merits of the case. They refused to discuss the validity of the condition. The tyranny involved in the imposition of this condition is matched by the conduct of the defendants in seeking to avoid a determination on the merits.

# POINTS

## I.

**Condition No. 4 is invalid because there is no warrant or authority in law for the imposition of any condition remotely resembling that condition.**

That there was no authority in the Board of Governors to impose Condition No. 4 is so clear that there was no endeavor on the part of the Board or any of the defendants in the District Court to support its validity. In fact counsel for the Board made the following statement in his oral argument in the District Court:

> "For proper disposition of each of the motions before this court, it may be assumed, for the sake of argument, that the condition is invalid, and still the motion should be sustained (R., p. 125).*

(1) *The Board has power to attach only such conditions to its permit as are authorized by statute. No authority can be found in the statute for condition No. 4.*

The source of authority in the Board to impose any conditions upon the acquisition by an applicant state bank of stock in a reserve bank is found in Section 321 of Title 12, reading in part as follows:

> A state bank * * * "desiring to become a member of the Federal reserve system, may make application to the Board of Governors of the Federal Reserve System, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. * * * The Board of Governors of the Federal Reserve System, subject to the provisions of this title and to *such conditions as*

* The Record would make it appear as if Mr. Owen made this statement. It was actually made by Mr. Leachman, counsel for the Board of Governors.

> *it may prescribe pursuant thereto* may permit the applying bank to become a stockholder of such Federal reserve bank''.

The question is, therefore, what conditions can the Board validly prescribe as being conditions prescribed ''pursuant'' to (i.e. authorized by) the provisions of Title 12?

The action of Congress with respect to Section 321 makes it very clear that Congress intended that the Board should not have authority to roam at large in the prescription of conditions. As this section was originally worded, it provided in broad language as follows (40 Stat. 233):

> ''The Federal Reserve Board, subject to such conditions as it may prescribe, may permit the applying bank to become a stockholder'' (Public Law No. 25, 65th Congress, approved June 21, 1917).

By Public Law No. 639 of the 69th Congress, approved February 25, 1927, the section was amended to read as it now does. In other words, Congress having originally granted to the Board very broad powers to prescribe conditions, saw fit to restrict these powers by the clear language of the section as it now reads, thereby requiring the Board to find express authority in the statute itself for such conditions as it might prescribe.

Further emphasis of the fact that the Board of Governors may not roam at large in imposing conditions, but must look to the authority granted by the statute, is given by Sections 327 and 328 of Title 12. Both sides agree that the only source of power in any body to enforce a condition that has been imposed upon an applicant bank and which comes into effect subsequent to its becoming a member, is found in Section 327. This section reads as follows:

> ''If at any time it shall appear to the Board of Governors of the Federal Reserve System that a member bank *has failed to comply with the provisions of sections 321-338, inclusive,* of this title, or the regulations of the Board of Governors of the Federal Reserve System made pursuant thereto,

> * * * it shall be within the power of the board after hearing to require such bank to surrender its stock in the Federal reserve bank * * *. The Board of Governors of the Federal Reserve System may restore membership upon due proof of compliance with the conditions *imposed by said sections.*''

It is noteworthy that this section authorizes the Board to exercise compulsion upon an offending bank only for failure to ''comply with the provisions of sections 321 to 338''. This thought is emphasized by the provision in the last sentence that proof of compliance with the *statute* entitles the erring bank to restoration to membership.

Further emphasis is given to the necessity for ''authority of law'' being found for a condition, by the provisions of Section 328, reading in part as follows:

> ''Whenever a member bank shall surrender its stock holdings in a Federal reserve bank, or *shall be ordered to do so* by the Board of Governors of the Federal Reserve System, *under authority of law,* all of its rights and privileges as a member bank shall thereupon cease and determine, and * * *''.

An example of the type of conditions which the Board is authorized to attach to its permit ''pursuant'' to Title 12 is indicated in Section 329(a) of Title 12. In that section the Board is authorized to admit a state bank to membership with less capital than the statute ordinarily requires (see Section 329); but in so doing, the Board was given the power ''in its discretion'' to require such bank to increase its capital and surplus. Here the exercise of a ''discretion'' is authorized. The applicant's continued membership may doubtless be conditioned upon meeting the Board's requirement as to increase.

By Regulation H, Section 6, the Board has established three standard conditions to be attached to every permit and consequently, in fact, attached to the permit given to the plaintiff. But these standard conditions are nothing more nor less than the Board's paraphrase of the requirements of the statute, and therefore place no resrictions

upon the conduct of the member bank other than those that the statute itself requires.

In Regulation H, Section 6, the Board states that "*pursuant to the authority contained in the first paragraph of Section 9 of the Federal Reserve Act*", viz: Section 321 of Title 12, U. S. C. A., "the Board * * * will prescribe the following conditions of membership for each State Bank hereafter applying for admission to the Federal Reserve System, and, in addition, such other conditions as may be considered necessary or advisable in the particular case". In the District Court, the Reserve Bank argued that condition No. 4 is one of "such other conditions" which the Board believes "necessary or advisable in the particular case." It is to be noted, however, that the Board, in Regulation H, Section 6, quotes as the source of its authority for the regulation, the limiting language of the statute, to wit, that the conditions must be such as "it may prescribe pursuant thereto". So the Board, in adopting the regulation clearly contemplated that these "other conditions as may be necessary or advisable in the particular case", must be conditions that are authorized by statute. In other words, in adopting this regulation, the Board was not seeking to enlarge its power to impose conditions. The result therefore is that, notwithstanding this reservation by the Board, in its regulations, of the right to impose "such other conditions", we are right back on the question as to whether the particular other condition was one which was authorized by the statute.

If a condition is not one that has been expressly authorized by the provisions of Title 12, if the statute is absolutely silent on any such a condition, how could it be said that a condition in no way envisaged by any provision of Title 12 was a condition prescribed "pursuant thereto". For example, assume that the Board might deem it a wise policy, in order to assure continued good management of a bank, that no president should be chosen by the directors of a bank without the prior approval of the Board. At least one of the matters which the Board is required to look into as a prerequisite to granting an application is the charac-

ter of the management of the bank (Section 322). Yet we do not believe that any one would be bold enough to assert that the prescription by the Board, as a condition of the granting of an application, that it should have to approve each and every president before elected, would be deemed to be a condition prescribed pursuant to the provisions of Title 12.

The law is too well settled for argument that a regulation (and the same rule applies to a condition in a particular case) must be in harmony with the statute in order to be valid. As the Court said in *Manhattan General Equipment Company* v. *Commissioner,* 297 U. S. 129, 56 Sup. Ct. 397, 8 L. Ed. 528 at page 134:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress —but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. *Lynch* v. *Tilden Produce Co.,* 265 U. S. 315, 320-322; *Miller* v. *United States,* 294 U. S. 435, 439-440, and cases cited."

The Court decided in the *Manhattan* case that the regulation in question was invalid because both inconsistent with the statute and unreasonable.

In *Waite* v. *Macy,* 246 U. S. 606 (1918), the plaintiff sought an injunction to prevent the appellants, as constituting the board of general appraisers known as the Tea Board, from applying to tea imported by the plaintiff tests which it was alleged were illegal and which, if applied, would lead to the exclusion of the tea. The Court found that the regulation established a ground for exclusion of the tea not recognized by the statute and therefore sustained the injunction, saying, at page 610:

> "The Secretary and the board must keep within the statute, *Merrit* v. *Welsh,* 104 U. S. 694, which

goes to their jurisdiction, see *Interstate Commerce Commission* v. *Northern Pacific Ry. Co.,* 216 U. S. 538, 544 * * *".

In *Morrill* v. *Jones,* 106 U. S. 466, 1 Sup. Ct. 423, 27 L. Ed. 267 (1882) Jones sued Morrill, a collector of customs, to recover duties paid under protest. The statute provided that animals imported for breeding purposes should be admitted free, under such regulations as the Secretary of the Treasury might prescribe. The Secretary had adopted a regulation providing that the collector should "be satisfied that the animals are of superior stock". The court held that the regulation was in excess of the power of the Secretary and invalid.

It is to be noted that neither in *Waite* v. *Macy, supra,* nor in *Morrill* v. *Jones, supra,* was the Secretary of the Treasury a party defendant to the suit. In both cases the subaltern, alone, was sued.

Accord:

*Campbell* v. *Galeno Chemical Co.,* 281 U. S. 599, at 610 50 Sup. Ct. 85, 74 L. Ed. 607 (1930);
*International Railway Co.* v. *Davidson,* 257 U. S. 506, 42 Sup. Ct. 506, 66 L. Ed. 341 (1922);
*Miller* v. *U. S.,* 294 U. S. 435, 55 Sup. Ct. 440, 79 L. Ed. 977 (1935);
*Vom Baur Federal Administrative Law,* Vol. 1, Section 499;
*Lynch* v. *Tilden Produce Co.,* 265 U. S. 315, 44 Sup. Ct. 488, 68 L. Ed. 1034 (1924).

(2) *The statute prescribes with considerable particularity the factors to be considered by the Board in passing upon an application under Sec. 321. The Board, in passing upon a state bank's application, has no authority to "consider" whether its stock is then or may thereafter be held by a holding company.*

The statute expressly provides for the matters which the Board must take into consideration in passing upon the

application of a state bank for permission to acquire stock in a reserve bank. The section of Title 12 following Section 321, is headed "Determination on Application" (Sec. 322). It is therein provided:

> "In acting upon such application the Board of Governors of the Federal Reserve System shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this chapter".

Upon becoming a member bank, the applying state bank, *ipso facto,* becomes an insured bank under that part of the Federal Reserve Act which creates the Federal Deposit Insurance Corporation, and in which it is provided as follows (Sec. 264 of Title 12, subsec. (e), paragraph (2)):

> "After August 23, 1935 * * * every state bank * * * which becomes a member of the Federal Reserve System, shall be an insured bank from the time it * * * becomes a member of the Federal Reserve System. The certificate herein prescribed shall be issued to the Corporation" (viz: Federal Deposit Insurance Corporation) "by the Board of Governors of the Federal Reserve System in the case of such State member bank * * *. Such certificate shall state that the bank * * * is a member of the Federal Reserve System in the case of a State member bank, and that consideration has been given to the factors enumerated in subsection (g) of this section".

Subsection (g) reads as follows:

> "The factors to be enumerated in the certificate required under subsection (e) and to be considered by the board of directors [of the Federal Deposit Insurance Corporation] under subsection (f) shall be the following: The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this section."

By the application of the doctrine *expressio unius exclusio alterius,* it would thus appear that the only factors to be taken into account by the Board in passing upon the application of a state bank for permission to become a stockholder, are the factors expressed in Section 322 and in subsection (g) of Section 264. "The conditions pursuant thereto" which the Board of Governors may prescribe in permitting an applying bank to become a stockholder must, in the absence of other prescribed conditions of the statute (and there are none), have to do with the matters which the Board is required by other sections to "consider" in passing upon the application of the applying bank. Consequently, since these matters to be considered have no connection, even remote, with stock ownership it can be stated with conviction that neither the Board nor the Reserve Bank had authority to consider and then impose conditions affecting stock ownership in the applying state bank by a holding company.

(3) *Not only is there no authority in the statute for condition No. 4, but it is in direct conflict with several provisions of the statute.*

(a) First, it runs counter to a number of provisions expressly contemplating that the stock of a state member bank may be held by a holding company affiliate. Referring to the very elaborate provisions with respect to the powers given to the Board over holding company affiliates of member banks, it will be seen that the Board has no power to exclude *a national bank* from membership in the system, because of the ownership of any of its stock by a holding company. Since national banks and state member banks are, under the statute, to have an identical status as members of the reserve system, the Board, therefore, has no power to exclude a state bank from membership because of the fact, if such be the fact, that, *at the time of its application,* all or any portion of its stock was owned by a holding company. Much less would it have power subsequently to remove it for that reason.

There are a number of sections of the statute which give clear recognition to the propriety of the stock of a state member bank being owned by a holding company. Section 304 of Title 12, with respect to voting for Class A and Class B directors of the Federal Reserve Bank, provides that:

> "whenever any two or more member banks within the same Federal reserve district are affiliated with the same holding company affiliate, participation by such member banks in any such nomination or election shall be confined to one of such banks, which may be designated for the purpose by such holding company affiliate."

Section 334, Title 12, which is one of the sections of that portion of the Act which specifically applies to "State banks as members of the System" provides that with respect to state member banks admitted to membership under Section 321, reports shall be obtained containing such information as in the judgment of the Board of Governors shall be necessary "to disclose fully the relations between such affiliate and such bank and to enable the Board to inform itself as to the effect of such relation upon the affairs of such bank". The Section also provides that the term "affiliate" shall include holding company affiliates, as well as other affiliates.

There is, also, a general provision with respect to holding company affiliates of state member banks, to wit, Section 337, reading as follows:

> "Each State member bank affiliated with a holding company affiliate shall obtain from such holding company affiliate, within such time as the Board of Governors of the Federal Reserve System shall prescribe, an agreement that such holding company affiliate shall be subject to the same conditions and limitations as are applicable under section 61 of this title, in the case of holding company affiliates of national banks. * * * Whenever the Board of Governors of the Federal Reserve System shall have revoked the voting permit of any such holding company affiliate, the Board of Governors of the Federal Reserve System may, in its discretion, require any

> or all State member banks affiliated with such holding company affiliate to surrender their stock in the Federal reserve bank and to forfeit all rights and privileges of membership in the Federal Reserve System as provided in sections 321-338 of this title."

Section 61, of Title 12 of the U. S. C. A. (R. S. 5144) provides for a holding company affiliate entering into certain agreements in connection with its application for a voting permit but it is not required to enter into any agreement to limit its right to acquire stock in any bank—*expressio unius exclusio alterius.* It is expressly provided in Section 61 that "if at any time it shall appear to the Board of Governors of the Federal Reserve System that any holding company affiliate has violated any of the provisions of the Banking Act of 1933 *or of any agreement made pursuant to this Section,* the Board of Governors of the Federal Reserve System may, in its discretion, revoke any such voting permit after giving sixty days' notice to the holding company affiliate by registered mail of its intention so to do and affording it an opportunity to be heard".

Since the Banking Act expressly provides that a state member bank shall bind its holding company to an agreement that it shall be subject to the *"same conditions and limitations"* as are applicable in the case of holding company affiliates of national banks and since the agreements the holding company is required to enter into with the national bank are expressly enumerated and clearly do not include anything relating to the purchase of stock or the quantum thereof in such or any other bank (see Sec. 61 of Title 12, U. S. C. A. (R. S. 5144), it is clear to a demonstration that the attempt to impose additional burdens upon a state bank in this respect is in derogation of the statute (Sec. 337 above). The statute obligates the member bank to obtain an agreement from the holding company and it, and necessarily the bank also, shall be subject to the "same conditions and limitations as are applicable in the case of holding company affiliates of

national banks". This is further rendered even more certain by the provision quoted above (Sec. 337) which shows that for a violation by the holding company affiliate (Secs. 337 and 61, Title 12, of the U. S. C. A., R. S. 5144) the Board of Governors is authorized to revoke the voting permit for a "violation of any agreements made pursuant to the section or of the Banking Act of 1933" and when revoked, the Board is expressly authorized to "require any or all state banks affiliated with such holding company affiliate to surrender their stock in the Federal Reserve Bank and to forfeit all rights and privileges of membership in the Federal Reserve System as provided in this Section."

The propriety of the existence of holding company affiliates of State member banks is further recognized in:—

Section 338, which has to do with the examination of such affiliates by examiners selected by the Board.

Section 371(c) which provides that no member bank shall make loans to or purchase the securities of affiliates or accept the same as collateral, except under certain conditions and within limitations therein prescribed.

Section 337 which expressly prohibits a member bank having affiliation with any corporation, etc., engaged principally in the issue of flotation of securities. Under the doctrine of *expressio unius exclusio alterius,* this would permit affiliation with other types of corporations.

Section 486 which provides for the waiver of requirements as to reports from affiliates in certain cases.

**From these statutes three things, at least, are apparent:—**

1. That a bank holding company is recognized by law as a legitimate organization which may freely operate under a strictly limited supervision of the Board of Governors of the Federal Reserve System.

2. That no power exists in the Board of Governors to place any restriction whatsoever on the acquisition by a holding company of any amount of stock in either a state member bank or a national bank.

3. That a state bank is entitled to membership in the Federal Reserve System on the *same terms and conditions* as a national bank.

In the face of all these provisions, it is clear that as one of the "conditions * * * *pursuant thereto*" which the Board of Governors may prescribe in connection with its permit to an applying state bank to become a stockholder, it cannot prescribe that the state bank shall not have a holding company affiliate. Congress has clearly recognized that this is beyond the control of the Board and of the Reserve Bank. Obviously, the greater includes the lesser, and therefore it is clear that the Board may not prescribe that if any of the stock (no matter how little) of the applying state bank shall subsequently be acquired by a holding company, the bank may lose its rights as a member bank.

(b) Another provision of the statute to which the imposition of a condition such as condition No. 4 runs squarely counter is found in Section 330, Title 12, U. S. C. A., reading:

> "Subject to the provisions of this chapter and to the regulations of the board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks: * * *."

But one of the "charter and statutory rights" which it has as a state bank is that its stock may be held without restriction by any holder of any kind whatsoever. The laws of California impose no restrictions whatsoever upon the ownership of stock of the Peoples Bank by Transamerica, or any other company. In this connection, see the illuminating opinion of Acting Attorney-General John W. Davis in 31 Opinions of the Attorneys General 153, in the matter of state banks joining the Federal Reserve System. Further, it is a "privilege", certainly, of national member banks, to have the stock thereof owned in part or in whole by a hold-

ing company. That being a privilege of a national member bank, it is, by virtue of Section 330 also a privilege of a state member bank.

(c) Another provision of the statute to which the imposition of condition No. 4 runs counter is the provision of Section 328 of Title 12, which authorizes state member banks "desiring" to withdraw from the system to do so. Condition No. 4 is a requirement that the plaintiff bank will, to quote the condition, "withdraw from membership", not when it so desires, not when its then board of directors finds it in its interest to do so, but, due to a condition imposed on it in May, 1942, when through some circumstances over which it has no control, to wit, the acquisition by Transamerica of some stock therein, the Board of Governors requests it to withdraw. That which is *voluntary* under the statute is sought to be made *compulsory* by the condition. "The membership of a state bank in the Federal Reserve System is * * * purely voluntary both in its inception and duration" (*Fidelity-Philadelphia Trust Co.* v. *Hines,* 10 A. (2d) 553, 337 Pa. 48 (Sup. Ct. Pa., 1940).

Upon examination, it will be seen that this compulsory withdrawal provided for by condition No. 4 is not in conformity with Section 328 in a number of other respects.

(d) Still another provision of the statute to which condition No. 4 runs counter is the provision of Section 301 of Title 12 reading in part as follows:

> "Every Federal reserve bank shall be conducted under the supervision and control of a board of directors. * * * Said board of directors shall administer the affairs of said bank fairly and impartially and *without discrimination* in favor of or against any member bank or banks * * *."

The Reserve Bank contended in the District Court that Section 301 has no applicability because it only has to do with "plaintiff's treatment as a member bank", and the condition was exacted "before it became a member". The answer to this is that the condition was one which was to

become operative *after* the plaintiff became a member bank, and it had to do with the kind of treatment it should receive *after* it became a member bank. The plaintiff is now a member bank and is now threatened with proceedings for the enforcement of condition No. 4. Since condition No. 4 has not been and could not be imposed upon national banks which are members of the system, to deprive the plaintiff of its stock, of its privileges of rediscount, etc., as a member bank, because of Transamerica's ownership of stock in the plaintiff, would be to discriminate against it, contrary to the above quoted provisions of Section 301 of Title 12. Such potential future discrimination was one of the unauthorized and invalid contemplations of the condition when it was imposed by the defendants on the plaintiff. The invalid condition cannot be made effective as to the plaintiff bank except by depriving it of the privileges of membership in the defendant Reserve Bank by acts and omissions of the board of directors of the Reserve Bank which are discriminatory against the plaintiff and consequently expressly forbidden.

(e) Still another provision of the statute to which condition No. 4 runs counter is the provision of paragraph (2) of subsection (y) of Section 264 of Title 12 (Federal Deposit Insurance Law), reading in part as follows:

> "It is not the purpose of this section to discriminate, *in any manner,* against State nonmember, and in favor of, national or member banks; but the purpose is *to provide all banks with the same opportunity to obtain and enjoy the benefits of this section.*" viz., the benefits of insurance of deposits.

Condition No. 4, however, provides for the termination of the status of the plaintiff as an insured bank for a reason unauthorized by the statute and peculiar to this particular bank. It therefore deprives this bank of the same opportunity "to obtain and enjoy the benefits" of federal deposit insurance as is given to "ALL" other banks.

We have this most anomalous position with respect to the plaintiff bank. It could not become a member bank without the Board having ascertained that the situation

was such as to entitle it to become an insured bank (Section 264, subsection (e) Paragraph 2). *So we must assume that it could have become an insured bank without having become a member bank.* In becoming merely a nonmember insured bank, *no conditions of any kind could have been imposed upon it by the Federal Deposit Insurance Corporation.* (See Sec. 264 of Title 12.) Consequently, the acquisition of 500 shares of the stock in the plaintiff bank by Transamerica would not have any effect whatsoever upon its status as a nonmember insured bank.

Nevertheless, it is now claimed that, having become a member bank under the terms of condition No. 4, it can automatically be deprived of its status as an insured bank by being deprived of its status as a member bank, thereby depriving it of the "same opportunity to obtain and enjoy the benefits" of federal deposit insurance along with "all banks". This is in direct conflict with subsection (y) of Section 264, which says that this discrimination shall not take place *"in any manner"*.

A study of the statutes makes it clear that it was never intended by Congress that a bank should be deprived of its status as a member bank, or its status as an insured bank, except for plain violations of specific provisions of the statute, particularly provisions having to do with unsound and unsafe banking practices, or with the misconduct of its officers in direct violation of the law (see Sec. 264, Tit. 12, Subsec. (i)).

(4) *The history of the statute demonstrates that the Board had no authority to impose condition No. 4.*

As further showing that Section 321 was never deemed by Congress to give the Board authority to impose condition No. 4, it should be noted that both in the Banking Act of 1933 and Banking Act of 1935, provision was made whereby it was compulsory for State banks to become members of the Federal Reserve System by a stated time in order to retain their status as, or to become, insured banks*. Sub-

* The Banking Act of 1933 required all State banks to become member banks by July 1, 1936, in order to remain or become insured. Section 8, Banking Act, 1933, 12B (1)(y).

section (y) of Section 264 of Title 12 as enacted August 23, 1935 contained a similar provision which has since been repealed. It is obvious that when Congress required membership in the Reserve System to be obtained in order that the banks be continued as insured banks it did not authorize discrimination to be practised against those which might have corporate shareholders. Stock in many such state banks throughout the country were held by corporations which were capable of becoming holding company affiliates. To have excluded them from membership in the System and insurance because some corporation owned a few shares of their stock would have been unthinkable.

(5) *There are many convincing indications that the Board of Governors knew that it had no authority to attach condition No. 4 to its permit.*

(*a*) *The very framework of the condition and the exaction of an express agreement of compliance are admissions of lack of authority.*

The framework of the condition is quite peculiar. If a condition were one which the Board is authorized to attach to a permit, then upon the failure of such member bank to comply with the terms of the condition, the Board has authority to *compel* such member bank to retire from the system through the surrender of its stock, by proceeding under Section 327 of Title 12.

*The very fact that the plaintiff bank was required to accept the condition and to agree to comply therewith is cogent evidence that neither the Board nor the defendant Reserve Bank felt that it could, relying solely on its own power, impose the condition and make it effective.* It is no part of the scheme of the statute or of the regulations that the applying member bank should be required in express terms to accept valid conditions and to agree to comply therewith. Valid conditions are completely efficacious by virtue of their own strength, unsupplemented by any agreement. The statute will be searched in vain for any provision making membership in the Reserve System a subject of contract.

Further, condition No. 4, instead of being worded as a type of condition which could be compulsorily enforced under Sec. 327, is worded in terms of obtaining an undertaking on the part of the plaintiff bank that it would "withdraw". Valid conditions can be enforced by the Board by virtue of its own power alone. Now, the only provision for withdrawal by a member bank is contained in Section 328 of Title 12, entitled "Withdrawals from Membership". This is a section having to do with *voluntary* withdrawals. It reads in part as follows:

> "Any state bank or trust company desiring to withdraw from membership in a Federal reserve bank may do so * * * upon the surrender and cancellation of all of its holdings of capital stock in the Federal reserve bank * * *."

It thus appears that at the very outset the Board was clear in its own mind that it had no power to impose the terms of No. 4 as a *condition,* and consequently it was seeking to accomplish its unauthorized purpose by exacting from the plaintiff a promise to exercise a privilege that would belong to plaintiff—something that the Board clearly had no right to do; also something that the board of directors of the plaintiff bank could not properly agree to in view of their constant and continuing obligation to the depositors and stockholders as well as their legal inability to bind their successors. The statute vests the option of withdrawal in the member bank and no one else.

(*b*) *The Board of Governors has, in effect, publicly and officially admitted that it had no authority to impose condition No. 4.*

If further proof were needed of the lack of authority on the part of the Board to limit the rights of plaintiff by the imposition of such a condition as condition No. 4, we need only refer to the official annual report of the Board of Governors for the year 1943 (dated April 29, 1944), required by law, in which the Board expressly states that it has no authority to limit the growth of bank holding

companies and no regulatory powers over them except in connection with the granting or refusing to grant a permit to the holding company, permitting it to vote its stock in a bank which it controls.

In other words, it in effect, asserted that it had no power to regulate holding companies in any way by the imposition of a condition upon an applicant state bank, such as condition No. 4.

The report reads, in part, as follows:

> "RECOMMENDED LEGISLATION ON BANK HOLDING COMPANIES.
>
> "In the Banking Act of 1933 the Congress undertook to provide for the supervision of bank holding companies. The Board, in the light of its experience, believes the present law inadequate to accomplish the purposes for which it was enacted. * * *
>
> *"Secondly, the only limitation which the law imposes upon the control of subsidiary banks by bank holding companies is that the latter may not vote their stock in a controlled bank without securing a voting permit from the Board, and it is only as an incident to obtaining the voting permit that there is any regulation at all."* * * *
>
> *"There is now no effective control over the expansion of bank holding companies either in banking or in any other field in which they may choose to expand.* * * *
>
> "It is recognized that bank holding companies have served a useful purpose in some areas of the country and have contributed banking services which might not otherwise have been available or might not now be available * * *.
>
> "For these reasons the Board recommends *that immediate legislation be enacted preventing further expansion of existing bank holding companies or the creation of new bank holding companies* * * *".

The Supreme Court of the United States in a recent opinion has held that an administrative agency cannot employ administrative measures founded upon misapprehension of the legal rights of the parties in order to effect a change of policy for which legislation had been sought.

*Arenas* v. *United States,* 322 U. S. 419, 64 Sup. Ct. 1090, 88 L. Ed. 996 (1944).

**The invalidity of condition No. 4 does not arise from any abuse of discretion but arises from a total lack of authority in the Board of Governors to impose such a condition.**

The gist of the complaint is that condition No. 4 was imposed upon the plaintiff without any warrant in law whatsoever (Par. VIII of the complaint, R., pp. 8, 9). The excerpt which we have just quoted above (p. 31) from the annual report of the Board of Governors, admits, in effect, a total lack of any power whatsoever to regulate holding company ownership of the stock of a state member bank.

In their brief in the District Court, counsel for the Board of Governors made the following very cogent statement:

> *"Plaintiff pleads that the condition No. 4 is ultra vires, null and void in all respects; that the Board had no authority in law to prescribe or exact such condition. The condition is pleaded in haec verba (IV). The Board's power or authority to prescribe or exact this condition is or is not found in the law. It either has the power or it has not. If it has the power, no court can interfere with the exercise of it. If it does not have the power, the condition, as pleaded by plaintiff, is null and void. It is only necessary to read the condition to determine whether or not it has the power, since everyone is presumed to know the law. A mere reading of the condition gives the answer whether or not it is a valid provision.* * * *." (Italics ours). (R., p. 122).

With this statement we are in entire agreement.

Where the validity of the condition turns upon whether there has been proper or an improper exercise of discretion, then of course "a mere reading" of the condition cannot demonstrate its validity or invalidity. In cases where discretion is involved, the imposing authority must have a day in court in which to justify its action as a proper

exercise of discretion. It must have an opportunity to come forward with the reasons which motivated the taking of the action complained of. But in this case both parties agree that condition No. 4 is either valid or invalid on its face.

The circumstance that the Board of Governors had some discretion as to the conditions they would impose, *within the limited range of their authority* with respect to the imposition of conditions, has no bearing on the question before the Court. Condition No. 4 is obviously outside of the realm of that authority and consequently outside the realm of any discretion. It was purely arbitrary and capricious, and as we have shown, p. 21 *et seq., supra,* even ran counter to several express statutory provisions.

*Absolutely no discretion existed in the Board either to impose or not to impose a condition such as condition No. 4.*

We therefore submit that even if, as was held by the Court below, the Board of Governors were the sole actors in the imposition of condition No. 4 (notwithstanding the allegations of the complaint to the contrary) it is clear that the Board of Governors was entirely without warrant or authority in law for the imposition of such a condition.

**Condition No. 4, Being Without Authority in Law, Is Absolutely Null and Void.**

As was said by the Supreme Court in the case of the *Manhattan General Equipment Company* v. *Commissioner of Internal Revenue,* 297 U. S. 129 at 134, 56 Sup. Ct. 397, 80 L. Ed. 528 (1936): "A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity." Condition No. 4 is such a nullity.

Accord *U. S.* v. *George,* 228 U. S. 14, 33 Sup. Ct. 412, 57 L. Ed. 712 (1913); *Waite* v. *Macy,* 246 U. S. 606, 38 Sup. Ct. 395, 62 L. Ed. 892 (1918); *Koshland* v. *Helvering,* 298 U. S. 441, 56 Sup. Ct. 767, 80 L. Ed. 1268 (1936); *Panama Refining Company* v. *Ryan,* 293 U. S. 388, 55 Sup. Ct. 241, 79 L. Ed. 446 (1935).

We do not have to stress this contention for the reason that the Board of Governors, in the quotation which we

have made from its brief in the Court below recognizes this rule and states it with great cogency (see quotation p. 32 *supra*).

## II.

**Not only is the condition invalid for complete lack of authority to impose any condition of that character and for that purpose, but it is also invalid because arbitrary, unreasonable and unjust, and because it is discriminatory.**

Obviously the plaintiff bank, as a bank, has no control over the conduct of its stockholders. Under California law they are entitled to sell their stock to whomsoever they please, and whensoever they please. Accordingly, in this case, without the knowledge or participation of the plaintiff bank, stock in the bank has been sold to the Transamerica Corporation. Assuming, for the moment, the condition to be a valid condition, and assuming that it can be compulsorily enforced in some manner, the consequence of condition No. 4 is that, the plaintiff bank, as a bank, will lose the privileges of being a member bank, and, *ipso facto,* will also lose its status as an insured bank. Both of these results are extremely detrimental to the interests of all the stockholders. The innocent stockholders who were stockholders in a bank enjoying all the valuable privileges of reserve membership and the advantageous standing of an insured bank, without any fault of their own, and not because of anything having to do with the condition of the bank, find themselves stockholders in what is a second rate and practically a black-listed bank. The market value of their stock in the appellant bank would obviously immediately tumble upon receipt of a notice to withdraw given by the Board of Governors under Condition No. 4, for, among other things, California Act 652A, Section 1 provides for double liability of shareholders of a state bank except with respect to shares in a bank whose deposits are insured by the Federal Deposit Insurance Corporation pursuant to the Federal Reserve Act as amended. Obviously

also the appellant bank itself would suffer in this connection, for any unissued stock of the bank which it might desire to sell for purpose of raising capital would have a diminished market value.

These consequences are also extremely detrimental to the interests of the depositors in the bank. The depositors find themselves in a condition where they have established a banking relation with a bank whose deposits at the time are insured, but after the enforcement of condition No. 4 of which they had no knowledge, they are depositors, if they desire to continue their established friendly relations, in a bank whose subsequent deposits are not insured and whose insured deposits will soon be exhausted. And all these consequences have nothing to do with the soundness of the bank nor with the prudent and safe manner in which its banking operations are being conducted. The bank may be the very soundest and best managed bank in the United States, and nevertheless, because of the seeming hostility of the present Board of Governors of the Federal Reserve System to Transamerica and to the Bank of America, these innocent stockholders and these depositors who have no interest in that situation are to be penalized.

It might well be in the particular case that Transamerica's interest in the bank greatly strengthens it and adds to its stability and capacity to do business. The Board in its 1943 Report, which we have quoted above, stated that "bank holding companies have served a useful purpose in some areas of the country, and have contributed banking services which might not otherwise have been available or might not now be available, * * *" (Rep. p. 37). We have no doubt that that is the fact in the instant case. The Peoples Bank having the benefit of the experienced advice of the Transamerica organization, and having the benefit of the financial support and aid of Transamerica, is a much stronger bank than it could possibly be with its purely local ownership.

Any condition which the statute authorizes the Board of Governors to impose pursuant to the statute, must be a condition which the bank has the power to perform. It must be a condition with respect to the performance or non-

performance of which the bank has control. In fact all the statutory provisions governing membership refer to the applying *bank* and to things which it must do, and not to its stockholders. To subject the bank to a condition which might deprive it of its membership in the system and of its status as an insured bank for an innocent and lawful act of a stockholder over which it has no control whatsoever, could never have been contemplated by Congress. We repeat, that the condition is arbitrary, unreasonable, unjust, and, we say, vicious.

Further, every valid condition must, *in its fundamental principle,* have universal application. *It must not be discriminatory.* The Board clearly has no right to prescribe that the Peoples Bank shall be required to surrender its stock and cease to be a member in the event that a particular holding company, or any holding company, should acquire an interest therein, unless it makes the same prescription with respect to every other existing state member bank or applying state bank and as affecting every possible holding company that might acquire a stock interest in the member bank through loans or otherwise. The right to discriminate in this situation would be an intolerable tyranny.

Transamerica owns sufficient stock in several member banks, both state and national, to make it a holding company affiliate of such banks and it has minority interests in other member banks. None of them has been inflicted with a condition No. 4. Another bank holding company, by way of example, owns the controlling stock of 80 or more banks and trust companies. Of the state banks owned by that corporation, several are members of the Federal Reserve System, and we make bold to assert that no such condition as condition No. 4, in any manner, shape or form, was attached to the admission of these state banks into the Federal Reserve System. As proof of the arbitrariness of this condition, we are prepared to show that since condition No. 4 was imposed on the plaintiff bank, another California state bank has been admitted to membership without the imposition of any such condition.

This point is well sustained in *Manhattan General Equipment Company* v. *Commissioner,* 297 U. S. 129, 56 Sup. Ct. 397, 80 L. Ed. 528 (1936), *supra,* p. 33. The Court said, at page 134:

> "And not only must a regulation, in order to be valid, be consistent with the statute, *but it must be reasonable. International Railway Company* v. *Davidson,* 257 U. S. 506, 514."

Accord *International Ry. Co.* v. *Davidson,* 257 U. S. 506, 42 Sup. Ct. 179, 66 L. Ed. 341 (1922);

*Nolan* v. *Morgan,* 69 F. (2d) 471 (C. C. A. 7th, 1934);

See also *Vom Baur, Federal Administrative Law,* Vol. 1, Section 500.

Nor can a regulation be discriminatory.

*Bailey* v. *Holland,* 126 F. (2d) 317, 322 (C. C. A. 4th, 1942).

## III.

**If the statute be construed as authorizing the Board to prescribe condition No. 4, the statute would be unconstitutional as involving a delegation of the legislative power vested in Congress alone under Section 1 of Article I of the Constitution, also in contravention of the delegation of legislative power to Congress in specific instances enumerated in Section 8 of Article I. Such exercise of power by the defendants is likewise unconstitutional as being in violation of the Fifth Amendment to the Constitution.**

We do not elaborate this point, inasmuch as no contention has been made that condition No. 4 was authorized by the statute.

It is an elementary principle of statutory construction that a statute should be construed, if possible, in such a manner as to avoid any conflict with the constitution. See

*Panama R. Co.* v. *Johnson,* 264 U. S. 375, 68 L. Ed. 748, 44 Sup. Ct. 391 (1924);

*Lewellyn* v. *Frick,* 268 U. S. 238, 69 L. Ed. 934, 45 Sup. Ct. 487 (1925);

*Hassett* v. *Welch,* 303 U. S. 303, 82 L. Ed. 858, 58 Sup. Ct. 559 (1938).

We submit that it is too clear for argument that Congress itself has no power to establish condition No. 4 by direct legislation. It can, of course, say that no bank shall be a member of the Federal Reserve System whose stock is held by a holding company, but it cannot pick out one bank and say to that bank alone that it shall not be admitted nor retained as a member if any of its stock is held by a holding company, while all other similarly situated banks may be admitted or retained. Nor can Congress by legislation expressly discriminate against any particular holding company as a holder of stock in a member bank or against a particular bank like the Bank of America, acquiring an interest through commercial loans or otherwise in a member bank, for Congress itself would have to make its legislation applicable to all institutions that were in the same situation.

*A fortiori,* if Congress itself could not legislate the condition, it could not delegate to an administrative board like the Board of Governors any express authority or any discretionary authority enabling it to impose such discriminatory condition. The plaintiff invokes the protection of the constitutional provisions referred to herein and specified in its complaint against any contemplated acts of the defendant bank taken pursuant to Condition No. 4.

*Schechter* v. *United States,* 295 U. S. 495, 79 L. Ed. 1570 (1935);

*Panama Refining Co.* v. *Ryan,* 293 U. S. 388, 70 L. Ed. 446 (1935).

## IV.

**The Board of Governors is not an indispensable party.**

This procedural point is the main defense of the Reserve Bank. The gist of the opinion of the District Court on this point follows (R., p. 161):

> "It is thus evident from the law that the Board is the only body vested by Congress with authority to admit and expel state member banks. * * * This being true, any act on the part of the Reserve Bank, looking to the imposition of conditions of membership or the enforcement thereof, would be an act on its part, without authority in law and without binding effect. * * * *As a subaltern without authority, the Reserve Bank may not be sued alone* for the alleged misfeasance of the admitted superior".

Citing: *Warner Valley Stock Co.* v. *Smith,* 165 U. S. 28, 34, 17 Sup. Ct. 225, 41 L. Ed. 621 (1897); *Gnerich* v. *Rutter,* 265 U. S. 388, 44 Sup. Ct. 532, 68 L. Ed. 1068 (1924); *Jewel Productions Inc.* v. *Morgenthau,* 100 F. (2d) 390 (C. C. A. 2d, 1938); *Neher* v. *Harwood,* 128 F. (2d) 846, 849 (C. C. A. 9th, 1942).

It is noteworthy that the District Court does not cite or in any way refer to *Colorado* v. *Toll,* 268 U. S. 228, 45 Sup. Ct. 505, 69 L. Ed. 927 (1924), *infra,* p. 40 or *Berdie* v. *Kurtz,* 75 F. (2d) 898 (C. C. A. 9th, 1935), *infra,* p. 41.

It is clear, we submit, that the District Court misapprehended the character of this suit. It discusses the suit, in the language quoted above, as if it were a suit against the Reserve Bank for "the alleged misfeasance of the admitted superior". Obviously, the Reserve Bank cannot be sued, either alone or in conjunction with any other defendant, for the misfeasance of the Board. The Reserve Bank can be sued only for its own wrongdoing. It is with respect to that wrongdoing, present and threatened, that this suit is brought. And it is because the Reserve Bank is a separate and independent wrongdoer, it is because the Reserve Bank has taken and proposes to take action of

its own, which is without warrant in law, that this suit can be brought against it alone *for a declaration of respective rights*—without the necessity of the presence of the Board of Governors as a party to the suit.

## The Law.

The applicable rule of law is stated by this Court in a well considered opinion to be that where the superior "had no authority whatsoever to issue the regulations complained of", "his actions assuming to authorize action by the subordinate were of no validity and left the subordinate as the actor subject to restraint." (*Neher* v. *Harwood,* 128 F. (2d) 846, at 849 (C. C. A. 9th, 1942).

The leading case is *Colorado* v. *Toll,* 268 U. S. 228, 45 Sup. Ct. 505, 69 L. Ed. 927 (1924). In that case, the State of Colorado brought a suit to enjoin the superintendent of the Rocky Mountain National Park from "enforcing certain regulations for the government of the park, which are alleged to be beyond the authority conferred by Acts of Congress and to interfere with the sovereign rights of the State". The regulation complained of was one adopted by the superior (the Secretary of the Interior) which refused permission to anyone to operate automobiles for hire in the park except one corporation which had received a permit. *There was no claim that the statute under which the regulations had been promulgated was unconstitutional.* The statute creating the Rocky Mountain National Park expressly made it the duty of the Secretary of the Interior to make reasonable rules and regulations for the management of the park, and expressly stated that such regulations should "include the provision for the use of automobiles therein" (Act of January 26, 1915, C. 19, 38 Stat. 798). The only complaint was that the particular regulation was entirely without authority. The court said (268 U. S. 228, at 230):

> "The object of the bill is to restrain an individual from doing acts that it is alleged that he has no authority to do and that derogate from the quasi-sovereign authority of the State. There is no question

> that a bill in equity is a proper remedy and that it may be pursued against the defendant without joining either his superior officers or the United States."

In *Berdie* v. *Kurtz,* 75 F. (2d) 898 (C. C. A., 9th, 1935), cited and discussed with approval in *Neher* v. *Harwood,* 128 F. (2d) 846, at 850, certain milk dealers brought a suit to enjoin the enforcement of certain licenses issued by the Secretary of Agriculture. The defendants were the officer in charge of the Los Angeles Office of the Field Investigation Section under the Agricultural Adjustment Act, member of the Milk Industry Board organized under the AAA, and the United States Attorney at Los Angeles. The Secretary of Agriculture was not made a party.

*No contention was made that the Act of Congress under which the Secretary of Agriculture was purporting to act was unconstitutional.* The contention was that the Act of Congress had not given the Secretary of Agriculture authority to do the particular act in question, to-wit, require licenses with respect to milk moving only in intrastate commerce. It was clear that the Secretary of Agriculture did have authority to issue licenses of the kind in question if such licenses were limited to transactions involving interstate commerce. This Court said (75 F. (2d) 898, at 905):

> "Appellants' next contention is that the Secretary of Agriculture is an indispensable party to this action. * * * The actions of the appellants who were seeking to carry out the regulations of the Secretary are not authorized by the act of Congress. The appellees are not engaged in 'interstate commerce', and as to them the actions of the appellants constitute trespass. Under such circumstances the appellants cannot shield themselves behind the unauthorized regulations. The Secretary is not a necessary party. *State of Colorado* v. *Toll,* 268 U. S. 228 * * *."

In *Neher* v. *Harwood,* 128 F. (2d) 846 (C. C. A. 9th, 1942), this Court reviewed at length most of the decisions having to do with the indispensability of the superior officer as a party defendant in a case brought against the inferior where it was claimed that there was no warrant or authority in law for the action involved. After discussing at

length *Warner Valley Stock Co.* v. *Smith,* 165 U. S. 28, 17 Sup. Ct. 225, 41 L. Ed. 621 (1897), and *Gnerich* v. *Rutter,* 265 U. S. 388, 44 Sup. Ct. 532, 68 L. Ed. 1068 (1924), upon which the defendants so much rely, and which the District Court cited in support of its opinion, and after discussing *Webster* v. *Fall,* 266 U. S. 507, 45 Sup. Ct. 148, 69 L. Ed. 411 (1925), this Court, in the *Neher* case, then considered *Colorado* v. *Toll, supra,* and said (128 F. (2d) 846 at 849):

> "The plaintiff in this case, it is clearly seen, was not claiming that the superior officer had abused a discretion legally vested in him, but rather that he had no statutory authority whatsoever to issue the regulations complained of. The confusion as to this case and the Gnerich and Webster cases now clears. The Supreme Court in Colorado *v.* Toll did not overrule these two former cases, but instead properly and logically discerned the principle upon which they differed. In the two former cases the superior officer had acted under a statute which was not attacked as unconstitutional, but it was contended that the superior had in some manner abused his discretion and in such circumstance it was held that he should be made a party to the action in order to defend his direction and regulations. Where he was without authority to act at all in the premises his actions assuming to authorize action by the subordinate were of no validity and left the subordinate as the actor subject to restraint."

The cases involving a question as to the indispensability of the superior as a party defendant have been collected and analyzed recently in the case of *Hartmann* v. *Federal Reserve Bank of Philadelphia,* 55 F. Supp. 801, (D. C., E. D. Pa., April, 1944).

See also:

*Waite* v. *Macy,* 246 U. S. 606, 38 Sup. Ct. 395, 62 L. Ed. 892 (1918).

*American School of Magnetic Healing* v. *McAnnulty,* 187 U. S. 94, 23 Sup. Ct. 33, 47 L. Ed. 90 (1902);

*Morrill* v. *Jones,* 106 U. S. 466 (1882);

*Street* v. *Lincoln Safe Deposit Co.,* 254 U. S. 88, 41 Sup. Ct. 31, 65 L. Ed. 151 (1920);

In all of these cases, as in the instant case, the following conditions existed:

1. There was an Act of Congress validly giving authority to the superior officer, *within certain limits,* to establish regulations, require licenses or impose conditions. Within the prescribed limits, the superior officer had discretion.

2. There was no authority given to the inferior by law or by regulation, to establish regulations, require licenses or impose conditions. The inferior in all the cases was, at best, "a subaltern without authority".

3. The superior officer had established a regulation, required a license or imposed a condition which was without any warrant in law. The superior officer had exceeded the authority given to him.

4. There was no authority in the statute given to the inferior (the subaltern) to take any action to enforce the regulation, or the license requirement or the condition in question.

5. The inferior had taken or was threatening to take action adversely affecting the plaintiff, basing his right to do so on the invalid regulation, license requirement or condition established initially by the superior.

In holding that "as a subaltern without authority, the Reserve Bank may not be sued alone for the alleged misfeasance of the admitted superior" (R., pp. 161, 162), the District Court in the instant case was, as above pointed out, deciding something as to which there is no controversy, and, at the same time, the Court was not dealing with the actual controversy and deciding it in accordance with the authorities. Its final determination was, we submit, erroneous.

Since this proceeding is based on the contention that neither the superior nor the subaltern had any warrant in law for the action complained of, they were both wrong-

doers; and each can be sued separately *with respect to its own acts.* In the language of this Court in the *Berdie* case, *supra,* their actions "constitute trespass".

The instant case is even stronger than any of these cases, because *the Federal Reserve Banks are not mere subordinates* of the Board. The Federal Reserve Banks are not the creatures of the Board of Governors. They are the independent corporations and creatures of the statute. Nor are the Reserve Banks the agents of the Board. True it is that in certain respects the Board of Governors has supervision over and in some cases can give direction as to certain of the activities of the Federal Reserve Banks. But, by and large, the Federal Reserve Banks, as independent corporations, conduct their affairs, in fact and as authorized by statute, pursuant to the action of their own Board of Directors and their own staff of officers. Section 301 of Title 12 provides that "Every Federal Reserve Bank shall be conducted under the supervision and control of a Board of Directors. The Board of Directors shall perform the duties usually appertaining to the office of directors of banking associations, and all such duties as are prescribed by the law". The Reserve Banks, their Boards of Directors, and their officers are not the agents, employees or subordinates of the Board.

Not only is there no actual relationship of superior and subordinate as between the Board of Governors and the defendant Reserve Bank, with respect to the conduct of the Reserve Bank in imposing the condition No. 4 upon the plaintiff, but the *Reserve Bank has no corporate power to act as the agent or subordinate of the Board in the situation.* The Reserve Banks are given power only to exercise the powers "specifically granted" by the provisions of Chapter 3 of Title 12, and "such incidental powers as shall be necessary to carry on the business of banking within the limits prescribed" by the chapter. The power to act as a subordinate to the Board with respect to the imposition of conditions on the acquisition of its stock, or to act as such subordinate in the enforcement of a condition is not one of these powers.

In the matter of the acquisition of stock in a Reserve Bank by a state bank, the Board of Governors has the function under the statute of granting the permit. But once the permit is granted, it is *functus* on that aspect of the question. Thereafter, the applicant state bank, armed with the permit, goes to the Reserve Bank, as it would to any other corporation, and upon its paying the requisite subscription price for his stock, is entitled to have its stock. Stock is issued to the applicant by the Reserve Bank as an independent functionary, not as a mere agent or conduit or employee or subordinate of the Board.

Nor is the Reserve Bank the agent or subordinate of the Board, in respect to any attempted enforcement of a condition. As we point out more at length hereafter (*infra,* p. 49), an order of the Board under Sections 327 and 328 of Title 12, designed to enforce a valid condition, is directed toward the offending member bank and requires action on its part, and is not in the nature of an order to or authorization to the Federal Reserve Bank.

The consequence is that both with respect to the imposition of conditions and also any action taken to make the same effective, the Reserve Bank has no standing at law to act as the subaltern or agent of the Board. Whatever it does, it does as an independent agency or as a volunteer. Since, as a mere subaltern, it can be required to stand suit alone for its own "trespass", *a fortiori,* it can be sued alone for what it does in an independent status or as a mere volunteer.

*Further, the Federal Reserve Agent is the only person having any power to act as the agent or representative of the Board in any capacity* within the twelfth Federal Reserve District. The statute is mandatory in this respect. It says (Section 305): "He" (the Federal Reserve Agent) "*shall* act as its" (the Board's) "official representative for the performance of the functions conferred upon it by this chapter."

One question, and one question only, has to be examined in connection with this matter of indispensable parties, to-wit: did the Board of Governors act without warrant or

authority in law in laying down condition No. 4? In other words, is condition No. 4 absolutely invalid? We have already shown the invalidity.

A final word on the question of the "indispensable" party. Congress has expressly endowed the defendant bank *with full capacity to sue and to be sued.* It has not expressly so endowed the Board. The clear implication from this is that *all* legal relationships with the bank will be subject to proper legal protection. Congress, itself, has answered the indispensable party argument.

Complete relief can be given the appellant in this proceeding. If the defendant Reserve Bank is held to have no right to take any action which is predicated, even remotely, on the validity of Condition No. 4, the plaintiff will continue to be a member of the reserve system.

## V.

**There is a "justiciable controversy" within the meaning of the Declaratory Judgment Statute (Section 400 of Title 28) between the plaintiff and the Reserve Bank. The Defendant Reserve Bank has many important steps to take in any attempted effective enforcement of condition No. 4 and it intends to take those steps.**

As one of its reasons why it thought that "the complaint fails to state a claim or cause of action", the District Court in its opinion stated that "as between plaintiff and the Reserve Bank, no justiciable controversy, in the legal sense, exists." (R., p. 160.) While the District Court elaborated its views on the other points on which it based its decision against the plaintiff, it did not in any way elaborate upon the statement just quoted.

(a) *The complaint clearly states a justiciable controversy* (Par. VIII thereof, p. 4, *supra*). It states that the defendants contend that condition No. 4 is in all respects valid and enforceable and empowers the defendants to deprive the plaintiff of its stock in the defendant Reserve

Bank and that the defendants intend to take proceedings "predicated on said condition No. 4" designed to deprive plaintiff of its ownership of said shares and that such "proceedings are imminent". In answer to this, the defendant Reserve Bank argued on the motion to dismiss: (1) that it had no lawful power to impose conditions—power in this respect being lodged only in the Board of Governors under Section 321 of Title 12; (2) that it had no power in law with respect to the enforcement of conditions—power in this respect being lodged only in the Board of Governors under Section 327 of Title 12; (3) that it did not in fact have anything to do with the imposition of condition No. 4; and (4) that it does not in fact intend to have anything to do with the enforcement thereof. Obviously contentions 3 and 4 are not open to the defendant Reserve Bank on its motion to dismiss, which for the purposes of the motion admits the allegations of the complaint. With respect to contentions 1 and 2, *lack of lawful power*—the whole basis of the plaintiff's suit is that there is no lawful power in anybody, whether it be the Board of Governors or the Reserve Bank or anyone else, either to impose condition No. 4 in the first place, or to enforce it in the second place. On the premise that we are dealing with an invalid condition (which for the purpose of these motions is not questioned by defendants, R. p. 125), the only question which the Court has to consider is whether or not the defendant is *an actor* who is himself taking steps or about to take steps against the plaintiff that have no warrant in law. The complaint alleges that the defendant Reserve Bank is such an actor,—that it is about to take proceedings predicated upon condition No. 4 designed to deprive plaintiff of its stock in that bank. On the motion to dismiss, this clearly states a case against the defendant Reserve Bank for a declaratory judgment.

(b) Entirely aside from the admitted allegations of the complaint, a *justiciable controversy exists in fact.* It is demonstrable that the defendant Reserve Bank would have many steps to take purely on its own, in any attempted effective enforcement of condition No. 4, and that when the

appropriate time comes to take action, it intends to take those steps.

On the subject of authority in law to enforce condition No. 4, the District Court said, among other things:

> "* * * *any act* on the part of the Reserve Bank, *looking to* the imposition of conditions of membership or *the enforcement thereof,* would be an act on its part without authority in law and without binding effect" (R., p. 161).

We agree with this statement, but what the District Court did not consider was the fact that, as alleged in the complaint, the defendant, nevertheless, threatens to take imminent action in the enforcement of the invalid Condition No. 4. That is the very basis of our suit. The lack of authority in the defendant to validly enforce the condition is not a reason why plaintiff should be dismissed, but a reason why plaintiff should prevail.

If, as in this case, the condition sought to be enforced is without warrant in law and a nullity, then obviously any act by any person whatsoever, either the Board or the Reserve Bank, in the attempted enforcement thereof, or in the execution of any order designed for the enforcement thereof, is likewise without warrant in law. In such a case, no order from the Board affords any authority to the Reserve Bank, and any act which the Reserve Bank performs in the attempted execution of or supplementing such an order is the act of a wrongdoer.

We respectfully submit that the District Court did not take into account that as against a State member bank rightfully resisting the attempted enforcement of an invalid condition, the order of enforcement of the Board would be invalid, and consequently any act of the Reserve Bank in the attempted effectuation thereof would be without authority and would constitute a trespass.

Section 327 of Title 12 is pointed to by the defendants as being the only source of authority in anybody to enforce valid conditions. This section and the following section, Section 328, read in part as follows:

> Section 327—"If at any time it shall appear to the Board of Governors of the Federal Reserve System that a member bank *has failed to comply with the provisions of sections 321-338, inclusive,* of this title, * * * it *shall be within the power of the board after hearing to require such bank to surrender its stock* in the Federal reserve bank and to forfeit all rights and privileges of membership."
>
> Section 328—"Whenever a member bank shall *surrender its stock* holdings in a Federal reserve bank, or *shall be ordered to do* so by the Board of Governors of the Federal Reserve System, *under authority of law,* all of its rights and privileges as a member bank shall thereupon cease and determine * * *."

Sections 327 and 328 contemplate a valid order by the Board based on a valid condition. The only order the Board can make pursuant to these sections is an order *to the offending bank* to "surrender its stock". It is not authorized by law to make any order of any kind directed *toward the particular Reserve Bank* in which the offending member bank has stock. There is no authority given by the Act, or to be given by the order of the Board to any Reserve Bank to do anything if the offending member bank does not, in obedience to the Board's order, *"surrender"* its stock.

*But action under Sections 327 and 328 is predicated upon a valid order based upon a valid condition.* In the instant case, we have to do with an invalid condition on which no valid order of any kind can be based. *It is to be assumed, therefore, that if the Board of Governors should make an order in the very language of Section 328, ordering the plaintiff bank to surrender its stock holdings in the defendant Reserve Bank, the plaintiff bank would refuse to comply with this order.* The plaintiff bank would say that the order of surrender had not been made as the statute required it to be made, to-wit, "under authority of law".

*A very important question in this case is—what would the defendant Reserve Bank then do under those circumstances?* If the Reserve Bank has nothing to do in those circumstances and *does not intend to do anything*

*whatsoever in those circumstances,* if at that juncture, it has no interest in the situation whatsoever, then, of course, the plaintiff states no cause of action against the defendant Reserve Bank, to have title to its stock quieted against the admittedly void and inoperative condition (see Point VII, *infra*). There would be *aside from Cal. Code Sec. 738* "no justiciable controversy, in a legal sense" between the plaintiff and the Reserve Bank.

**But, at that juncture, the Reserve Bank either would continue to recognize the plaintiff bank as a stockholder or it would refuse to do so. Which would it do?**

Can there be any question? It is clear, we submit, beyond peradventure of doubt, that not only would the Reserve Bank have many important steps to take at that juncture to make the condition effective but, also, that it clearly intends to take these steps. The bill of complaint alleges that it intends to take these steps (Par. V);—that it intends to do whatever it can to enforce the condition (Par. VIII, R., p. 8). The motion to dismiss admits the allegation.

The following things are, we believe, plain:

1. That the defendant Reserve Bank would recognize as valid and would cooperate in carrying out any order made by the Board of Governors in the attempted enforcement of condition No. 4. It would seek to terminate plaintiff's relation to it as a stockholder. So much was, in substance, asserted by counsel for the Board of Governors and for the Reserve Bank in the District Court (R., pp. 113, 125).

2. The defendant Reserve Bank would then proceed to cancel the shares of the plaintiff bank on the records of the Reserve Bank—notwithstanding that plaintiff refused to "*surrender*" its certificates. *So much was admitted by counsel for the Reserve Bank in argument in the District Court* (R., p. 114).

3. The Reserve Bank would also refuse to permit the plaintiff bank to exercise its right as a stockholder given to it by the statute (Sec. 304 of Title 12) to vote for directors of the Reserve Bank.

4. The Reserve Bank would also refuse to pay to the plaintiff bank dividends at the rate of 6% per annum upon the stock now held by the plaintiff bank in the Reserve Bank, which dividends are mandatory under the statute (Sec. 289 of Title 12).

5. The Reserve Bank would also seek to return to the plaintiff its cash subscription to the stock of the Reserve Bank (Sec. 328 of Title 12).

6. The Reserve Bank would also refuse to grant to the plaintiff the privileges of rediscount and other very valuable privileges to which the plaintiff, being a stockholder in the Reserve Bank, is entitled as a member of the Federal Reserve System.

Against a member bank which would insist upon its rights and refuse to surrender its stock pursuant to an order of the Board requiring it to do so, the Reserve Bank would, *beyond question and in every case,* whether the order of the Board was valid or not, take the steps catalogued above. If the order of the Board was a valid order based on a valid condition, the Reserve Bank would be justified in so acting. But if, as in this case, the order of the Board was an invalid order based on an invalid condition, then the Reserve Bank would not be justified. It would then be a wrongdoer.

The mere order of the Board of Governors directing the plaintiff bank to surrender its stock in the defendant Reserve Bank would be an idle gesture, unless and until supplemented by the action of the Reserve Bank in doing the only effective things that can be done to make the order effective. No matter what order the Board may make, seeking to require a surrender by the plaintiff of its stock, the final action, *the only action, that will give effect* to the Board's order against a non-complying plaintiff, *will be action by the defendant Reserve Bank.* It will be the Reserve Bank that will do the things we have catalogued above.

We have no doubt that, predicating its action upon an order issued by the Board purporting to act under Sec. 327,

and thereby in substance predicating its action on condition No. 4, the defendant Reserve Bank, in fact, would take steps designed to deprive the plaintiff of its ownership of its shares and of all the benefits thereof (see allegations in Paragraph VIII of Complaint). The complaint so alleges; the motion to dismiss admits the allegations.

*The conduct of the defendant and the admissions of its counsel admit of no other interpretation.*

As the Supreme Court said, per Justice Holmes, in *Waite* v. *Macy,* 246 U. S. 606, 38 Sup. Ct. 395, 62 L. Ed. 892 (1918) at 609:

> "But in this case the superior of the appellants had promulgated a rule for them to follow which is alleged to be beyond the power of the Secretary to make. It is said that the appellants are independent of the Secretary and that it is to be presumed that they will decide according to law, as they say in their answer. But if the avoidance of a direct statement as to their intent did not of itself warrant a presumption that they would obey orders, the admissions of their counsel were enough to make their intent to do so plain."

On this important question as to what the defendant Reserve Bank would actually do in the execution of any attempted enforcement of condition No. 4, the Reserve Bank has been quite unrealistic and quite evasive. In our main brief in the District Court we pointed out the steps which the Reserve Bank itself would necessarily have to take in the attempted effective enforcement of condition No. 4, as against a plaintiff who refuses to recognize the validity of any proceeding based on condition No. 4 (R., pp. 118, 119). They are the various steps just catalogued at page 50, *supra.* In its reply brief the Reserve Bank very carefully avoided any discussion whatsoever of our contentions in this respect.

When it came to oral argument, counsel for the Reserve Bank admitted that the Reserve Bank might have to do one thing at least, and that is, *cancel the stock on the books of the defendant Reserve Bank* (R., p. 114), although the

certificates had not been surrendered. He attempted to belittle that act by describing it as a "ministerial act" (R., p. 113). [How can an act that is designed to deprive plaintiff of his stock without a surrender of the certificates be regarded as a ministerial act?] In view of the importance of the particular question as to what the Reserve Bank would have to do to make any order of enforcement effective, counsel for the plaintiff at this point in the oral argument in the District Court interrupted counsel for the Reserve Bank and requested him to inform the Court as to what he had to say about the other acts which the plaintiff's counsel had contended in its main brief, as we herein contend, that the Reserve Bank would have to perform (R., p. 114). Did counsel for the Reserve Bank take the occasion to enlighten the Court and counsel on this subject matter? He did not. He refused to be interrupted (R., p. 114). And although again challenged in the argument to state what the Reserve Bank would do with respect to these matters (R., pp. 120 and 144), he again avoided a discussion of the matter when it came to his reply argument.

But counsel for the Board of Governors was not quite so evasive. There was no doubt in the mind of counsel for the Board that the Reserve Bank would have many acts to perform in the attempted effective enforcement of condition No. 4. And, consequently, counsel for the Board confronted the District Court with a dilemma. "What," he said in substance, "would the poor Reserve Bank do in the event that the District Court declared condition No. 4 invalid, and the Board nevertheless made an order seeking to enforce it?" (R., pp. 125, 126). He said, in fact: "Now, the officers of the Federal Reserve Bank of San Francisco would certainly be in a dilemma. They would be afraid not to go ahead and not recognize the plaintiff bank as a member because they would be presently subject to a contempt action by this Court. On the other hand under the law of this matter, they would be violating the direction and order of their superior in Washington if they continue to recognize them (plaintiff bank) as a member". (R., p. 126.) But how could any such dilemma exist if, as contended by the

Reserve Bank, no action on its part will be required to make effective an order of the Board under condition No. 4. The Board, at least, clearly recognizes that the only effective thing, to wit, the future non-recognition of the plaintiff as a member bank would be action of the local Reserve Bank.

And what was the action which counsel for the Board of Governors proposed as the action which might be taken by the Board to solve this dilemma? He proposed a most astounding solution—to wit, that the Board of Governors in the exercise of a power which it has under certain conditions (see subsection (f) of Section 248 of Title 12) might remove any officers of the Reserve Bank who would continue to recognize the plaintiff bank as a member (R., p. 126). This very proposed solution is a clear recognition by counsel for the Board that it is action of the Reserve Bank and action by it alone that would be necessary in order to make effective the enforcement of condition No. 4 by depriving the plaintiff of its privileges as a member bank.

But, clearly, subsection (f) of Section 248 of Title 12, which gives the Board the power to suspend or remove officers of a Federal Reserve Bank for "cause" could not be invoked by the Board to remove an officer who had continued to recognize the plaintiff bank as a member bank pursuant to a declaration of the Court in this suit to the effect that condition No. 4 was invalid, and consequently afforded no basis for a termination of plaintiff's membership in the Reserve System.

That the Board would contemplate nullifying the decree of this Court in such a manner is obviously an astounding proposal, even if the Board of Governors could treat the obedience by an officer of the bank to the declaration of this Court as good "cause" for his removal. Doubtless, in *Colorado* v. *Toll,* the Secretary of the Interior could have removed the Superintendent of the Parks who gave heed to the action of the Court in that case, taken in the absence of the Secretary of the Interior as a party to the suit. But, as above stated, this all makes it clear that the Board itself believes it to be necessary for the Reserve Bank to take

action in order to make any order of the Board effective against the plaintiff bank.

**We Challenge the Defendant Reserve Bank Either Specifically to Admit or Categorically and Specifically to Deny What We Herein Claim It Would Do.**

An excellent test of the action which the defendant Reserve Bank must in any event take to make condition No. 4 effective is given by the following illustration. Suppose that the Board proceeded to endeavor to enforce condition No. 4 by proceedings under Section 327, and that the plaintiff bank paid no attention to these proceedings, and that following the same, the Reserve Bank purported to cancel the plaintiff's stock in that bank. Suppose then, that the plaintiff bank, relying on the invalidity of the condition, refused to recognize any validity in the proceedings for the cancellation of its stock and sued the Reserve Bank for the dividends that are payable on its stock, pursuant to statute (Section 289 of Title 12). It is clear that in view of the invalidity of the condition, the Reserve Bank would have no defense.

In conclusion, therefore, on this point, a justiciable controversy exists as between the plaintiff and the defendant Reserve Bank within the purview of Section 400 of Title 28, U. S. C. A. The defendant Reserve Bank claims the right, if and when the Board of Governors makes an order purportedly acting under Sections 327 and 328 of Title 12, requiring the plaintiff to surrender its stock in the Reserve Bank, to take the steps catalogued above and it undoubtedly would take those steps. On the contrary, the plaintiff asserts that the Reserve Bank has no such right.

## VI.

**The suit, as a suit for declaratory judgment, is timely.**

The complaint alleges and the motion to dismiss admits that the defendants intend to take proceedings predicated on condition No. 4, designed to deprive the plaintiff of its ownership of shares in the defendant Reserve Bank, and

that such proceedings are "imminent". The Court's assumption that the lapse of time since the suit was brought, with no proceedings having been taken, shows lack of imminence is not warranted. It ignores both the allegation in the complaint and the practical realities in conducting a litigation of this importance. Obviously, *as a mere matter of comity and prudent conduct,* confronted with this suit which is a challenge to their power, none of the defendants would proceed to seek to enforce condition No. 4 until the suit is disposed of.

That the suit was at least not "technically premature" was admitted by counsel for the Reserve Bank on oral argument in the District Court (R., p. 111).

Even if proceedings are not imminent, the law does not require the plaintiff to continue under the threat of this invalid condition, with its detriment to the plaintiff's business, while the Board of Governors and the Reserve Bank make up their minds whether or not they will endeavor to enforce the condition. That they intend to endeavor to enforce it is to be assumed from the fact of its imposition and from their conduct with respect to this lawsuit.

A declaration of its rights at the present time is of the utmost practical importance to the plaintiff bank. Unless the bank can bring this proceeding now, it must live indefinitely under the constant threat of this invalid condition. It is entitled to relief from an existing intolerable situation. It is hampered right now in every direction in the conduct of its business. Its goodwill is affected. The menace of this situation is causing present damage, which, as in so many cases with which equity deals, is not susceptible of concrete proof. A financial institution must be at all times in a position to keep public confidence, which it cannot do if it is under jeopardy of adverse official action.

Among other things, how can the plaintiff find satisfactory answers to such questions as the following:

Can it conscientiously advertise its membership in the Reserve System without indicating its probationary character?

Can it continue to advertise that it is an insured bank (as it is required by law to do) without indicating that it may lose this status at practically any moment?

Can it seek new deposits, without warning the depositor of the circumstance that due to Transamerica's acquisition of 500 shares, it may lose its insurance?

Must it, in good faith, warn its present depositors of the situation?

California Act 652, Section 38 provides that "Any director, officer, agent or employee of any bank who * * * knowingly concurs in making or publishing any written report, exhibit or statement of its affairs or pecuniary condition containing any information which is false shall be guilty of a felony".

In seeking to attract new capital to meet the demands of its fast growing business, what kind of a statement could be made that would not defeat its purposes? It would clearly have to inform prospective investors that its membership in the reserve system and its status as an insured bank are held at the mere sufferance of the Board of Governors and the Reserve Bank who claim the right to terminate both at will and that there is nothing that the plaintiff bank can do to cure the situation.

Can it attract and retain in its service men of the highest ability while holding only a conditional membership in the Federal Reserve System?

These and many other similar questions indicate most emphatically that the *present problem* of dealing with this condition means much more to this plaintiff than to those who may regard it as an innocent experiment in paternalism.

Of course it does not appear on the face of the complaint, but, at the trial, we are prepared to prove that the present status of this condition—since the acquisition by Transamerica of its 500 shares—has occasioned a great deal of comment among interested people, in which serious question has been raised as to the status of the bank, to its detriment.

The plaintiff bank has absolutely no control over the situation. It has no means of stopping the enforcement of

the condition. It cannot rid itself of Transamerica's stock interest.

*It has conformed in every respect with the requirements of the Federal Deposit Insurance Law, and yet it may lose its insurance.*

*It has conformed in every respect with the requirements of the Federal Reserve Act, and yet it may lose its valuable membership in the Reserve System.*

One of its stockholders has, without the knowledge or consent of the plaintiff bank, done what he had a perfect right to do—he has sold his stock to Transamerica, and yet the investment of every other stockholder in the bank is seriously jeopardized.

These are not remote and academic possibilities. They are problems of which the management of the bank needs an immediate solution, and which in all justice they should have.

That the enforcement of the condition would cause irreparable damage to the plaintiff is not open to question. To lose its position as a member bank and consequently automatically to lose its position as an insured bank would do it the greatest harm. As was stated in the brief of the Reserve Bank in the District Court:

> "such membership carries with it certain prestige and many practical advantages". Citing *Hiatt* v. *U. S.* (C. C. A. 7th), 4 F. (2d) 374.

The very reasons given in support of the contention that suit is premature but in reality emphasize the wisdom of utilizing in this case the statutory remedy of declaratory judgment. The remedy is preventive.

On this point of timeliness, the District Court says:

> "* * * this suit does not present a proper case for injunctive relief, because in the complaint no coercion or compulsion in the legal sense is alleged, because it does not appear from the complaint that plaintiff is now confronted with any immediate or imminent danger of injury, irreparable or otherwise * * *". (R., p. 160).
>
> "The condition of membership complained of is certainly not self-executing * * *. But it is not

> alleged that the Board has taken any action of the kind described and, since over six months elapsed between the filing of the complaint in this suit and the hearing on the motions without a supplemental complaint being filed, it may be presumed that the Board has not yet acted. However that may be, it is clear that the complaint presents a case of anticipated, *possible injury, based, it seems largely, upon conjecture and not such a case of immediate and impending danger as would warrant injunctive relief.*'' (R., p. 163).

The District Court fell into error, we submit, in treating this action as if it were a suit for an injunction and nothing more (Opinion R., p. 149).

**This is not primarily a suit for injunctive relief. It is primarily a suit for a declaratory judgment.**

Entirely different rules of law apply to a suit in which the primary relief sought is an injunction than apply to a proceeding in which the primary relief sought is a declaratory judgment. The District Court failed entirely, we submit, to recognize this difference. Some of the essential differences are as follows:

1. *In a suit for a declaratory judgment, it is not essential for the plaintiff to allege, and consequently not essential for him to prove that he is threatened with irreparable injury.*

In *Nashville, Chattanooga & St. Louis Railway* v. *Wallace,* 288 U. S. 249, 53 Sup. Ct. 345, 77 L. Ed. 730 (1932), the plaintiff sought a declaratory judgment as to the validity of a Tennessee excise tax. The Court said (288 U. S. 249, at 262):

> ''Thus the narrow question presented for determination is whether the controversy before us, which would be justiciable in this Court if presented in a suit for injunction, is any the less so because through a modified procedure appellant has been permitted to present it in the state courts, without praying for an injunction *or alleging that irreparable injury will result from the collection of the tax.*''

The Court held that it properly had jurisdiction of the suit as a suit for declaratory judgment.

Consequently the case of *National War Labor Board* v. *Montgomery Ward & Co. Inc.,* 144 F. 2d 528, (C. A., D. C., 1944) upon which the District Court relied in this connection, is not in point. That was a straight-out action for an injunction, and, in such a case it might well be held that where the primary object of the proceeding is to get a permanent injunction, the complaint should state facts from which the Court, on a motion to dismiss, can determine that there is a possibility, at least, of imminent action and of irreparable damage.

2. *In a suit for a declaration of rights it is not necessary for the plaintiff to allege and consequently it is not necessary for him to prove that the plaintiff is threatened with any immediate and impending danger from any proposed action by the defendant as to which there is a controversy.*

Transamerica has acquired stock in the plaintiff bank. Condition No. 4 has become operative. The Board of Governors is in position to give notice to the plaintiff bank at any time. Naturally, as a matter of courtesy to the Court, they would not give notice during the pendency of this proceeding which involves the power to give the notice, so nothing is to be inferred from the fact that the notice has not been given to date. It is to be presumed that the condition was not imposed as an idle gesture, and that in due course the Board of Governors will give the requisite notice. At the trial we are in a position to prove the purpose for which the condition was imposed. It was expressly stated by the Board at the time of imposition and as so stated the purpose cannot be accomplished without enforcement. The vigor with which this proceeding is being fought by the defendants is consistent only with a purpose to utilize this vicious condition to the limit. *Waite* v. *Macy,* 246 U. S. 606, 609 (1918).

Of course, once the notice is given, everything else is automatic, so far as the Board is concerned. Under the condition, the plaintiff will be required to withdraw. If it does not voluntarily do so, the Board will undoubtedly

attempt to proceed under the provisions of Sections 327 and 328 of Title 12. Counsel for the Board practically said as much in the District Court (R., p. 125). The hearing provided for by Section 327 will be a perfunctory hearing; there will be nothing to be heard or considered. No question of fact will be involved. An order of the Board directing the plaintiff to surrender its stock is a foregone conclusion.

We have indicated (p. 56, *supra*) the present damage which this menacing situation creates with respect to the affairs of this bank. Nevertheless, it is the contention of the defendants and it is the holding of the District Court that under these circumstances, plaintiff is remediless. The District Court holds that the plaintiff must sit around with the sword of Damocles hanging over its head, awaiting the pleasure of the Board as to when it will cut the string and let the sword fall.

In so holding, the District Court entirely disregarded the established law with respect to declaratory judgments. The established rule is that where the plaintiff is confronted with a claim by a governmental agency that he is subject to the penalties of a statute or a regulation or a condition, which claim he denies, the plaintiff does not have to await the actual commencement of enforcement by that agency of its claimed authority, but can obtain relief from the threat through a declaration of rights, whenever the matter is of practical importance to the plaintiff. Such a declaration of rights is particularly the function of the court under the Declaratory Judgments Statute in cases where the plaintiff desires a declaration of non-liability under a governmental statute, regulation or condition. As was said by Judge Yankwich in his well-considered opinion in *Redlands' Foothills Groves* v. *Jacobs,* 30 F. Supp. 995, 1008 (D. C., S. D. Cal. 1940):

> "I can conceive of no good reason for not relieving a citizen of a threat of official action resulting from his relation to a governmental agency.
>
> "A declaration of non-liability as applied to such a relationship is, if at all, more important in these days of expansion of governmental frontiers, than a similar declaration as to contractual relations."

Borchard, in his outstanding work on "Declaratory Judgments", has stated as follows:

> "*Claim of Defendant's No-Right.* On the other hand, the existence or validity of the plaintiff's privileges may be brought to determination in the form of a demand for a negative declaration that the defendant has no right to do some particular act, diminishing or endangering the rights of the plaintiff. * * * Thus he may claim that the defendant has no right to demand money or salary, to reduce the plaintiff's salary, to discharge the plaintiff from employment, *to interfere with the plaintiff in the enjoyment of a franchise,* to exclude the plaintiff from drilling on defendant's land, to rescind a contract of sale, to repeal an appropriation, or to take other action violative of the plaintiff's rights under a contract. *In many of these cases injunction will not lie,* yet it is extremely important that the disputed claim be settled and *the plaintiff's rights quieted.* In some of these contested claims, the plaintiff demands stabilization or protection for rights endangered by the defendant's claim, rather than escape from any pending or potential liability to which he considers himself exposed" (Borchard, Declaratory Judgments, 2nd Ed., pp. 940-1).

The remedy of declaration is regarded as especially appropriate in cases where the person affected by particular governmental requirements claims the right to proceed free from such requirements. (Borchard, Declaratory Judgments, 2nd Ed., p. 969):

> "*Freedom from any governmental requirement,* which is believed unlawfully to impair the privileges of the individual may likewise be judicially asked in the form of a suit for a declaration of immunity."

See also, Borchard, *Declaratory Judgments,* 1939, 9 Brooklyn Law Review, 1, 24.

In *Redlands' Foothills Groves* v. *Jacobs,* 30 F. Supp. 995, *supra,* p. 61, the District Court held, among other things, that a declaratory judgment as to rights might be obtained by a plaintiff who was under the cloud of some gov-

ernmental regulation, although no such immediate and impending danger as to justify an injunction existed. The opinion in this case contains an excellent discussion of the applicable law.

In *Scott* v. *Alabama State Bridge Corporation,* 233 Ala. 12, 17, 169 So. 273, 277 (1936), the Court said:

> "Controversies touching the legality of the acts of public officials, or public agencies, challenged by parties whose interests are adversely affected, are one of the favored fields for such declaratory judgment, styled in the act and in the authorities, the 'declaration.' Official action, done or threatened, challenged as unlawful, a usurpation of official power, whether lack of authority appears in the terms of the statutes, or because of unconstitutionality thereof, are said to be determinable in this manner rather than force the parties to seek injunctive relief, which involves many questions going to the propriety of such relief."

*Altvater* v. *Freeman,* 319 U. S. 359, 63 Sup. Ct. 1115, 87 L. Ed. 1450 (1943), illustrates the propriety of the use of a declaratory judgment as a means of affording security to a plaintiff although he is not under any immediate danger of loss in the situation. In that case the defendant in a suit for the specific performance of a patent license agreement set up a counterclaim asking for a declaratory judgment, to the effect that the license agreement did not cover reissued patents and that the reissued patents were not valid. Pending the litigation, royalties were being paid under protest. Plaintiff claimed there was no justiciable controversy. The court said (319 U. S. 359, at 365):

> "Unless the injunction decree were modified, the only other course was to defy it, and to risk not only actual but treble damages in infringement suits * * *. It was the function of the Declaratory Judgments Act to afford relief against such peril and insecurity". Citing, among other authorities, *Borchard on Declaratory Judgments, Second Edition.*

If the situation is one in which an *injunction* would be granted against a danger threatened in the future, *a fortiori,*

a declaratory judgment could be obtained. The case of *Columbia Broadcasting System* v. *United States,* 316 U. S. 407, 62 Sup. Ct. 1194, 86 L. Ed. 1563 (1942) is in point, and has many resemblances to the instant situation. That was a suit for an injunction. It was there held that the invalid regulations promulgated by the Federal Communications Commission might be made the subject of attack in the courts, although there existed no immediate threat of the application of the regulation to the business of the plaintiff. The Court said (316 U. S. 407, at 417):

> "The regulations are not any the less reviewable because their promulgation did not operate of their own force to deny or cancel a license. It is enough that failure to comply with them penalizes licensees, and appellant, with whom they contract. If an administrative order has that effect it is reviewable and it does not cease to be so merely because it is not certain whether the Commission will institute proceedings to enforce the penalty incurred under its regulations for noncompliance."

So, in the instant case, the invalid condition penalizes the transfer of stock in the plaintiff bank and subjects the plaintiff bank to the gravest dangers, which, because of the present acquisition of stock by Transamerica, are right at hand. The plaintiff has the right to be free from these penalties, even if it is not certain whether the Board of Governors will, now, or three months from now, or a year from now, institute proceedings under the condition to enforce a penalty by depriving the plaintiff of its membership in the Federal Reserve System.

*Vicksburg Waterworks Co.* v. *Vicksburg,* 185 U. S. 65, 22 Sup. Ct. 585, 46 L. Ed. 808 (1902) is apposite. The case arose on a demurrer to a bill brought by the Water Company *to enjoin* the City of Vicksburg from proceeding with a plan to build a municipal plant, the building of which plant had been authorized by the State Legislature, it being contended that the contemplated action of the City was in violation of the Water Company's franchise. The Court held that the action which the City had taken to the date of the suit did not present a present case of a breach of the

contract with the plaintiff "but discloses an intention and attempt, *by subsequent legislation of the City,* to deprive the complainant of its rights under an existing contract". With respect to this aspect of the case the Court said (185 U. S. 65, at 82):

> "It is further contended that the bill does not disclose any actual proceeding on the part of the city to displace complainant's rights under the contract, that *mere apprehension that illegal action may be taken* by the city cannot be the basis of enjoining such action, and that therefore the Circuit Court did right in dismissing the bill. We cannot accede to this contention. It is one often made in cases where bills in equity are filed to prevent anticipated and threatened action. But it is one of the most valuable features of equity jurisdiction, to anticipate and prevent a threatened injury, where the damages would be insufficient or irreparable. The exercise of such jurisdiction is for the benefit of both parties; in disclosing to the defendant that he is proceeding without warrant of law, and in protecting the complainant from injuries which, if inflicted, would be wholly destructive of his rights."

This language is very pertinent to the present suit, particularly, inasmuch as this is a suit not for an injunction but for a declaratory judgment, a type of suit in which a Court customarily proceeds to disclose to the defendant that he is proceeding without warrant of law, although the plaintiff is not threatened with immediate irreparable injury.

In *United States* v. *Appalachian Power Co.,* 311 U. S. 377, 61 Sup. Ct. 291, 85 L. Ed. 243 (1940), the case arose on a dismissal of a bill brought by the United States against the Power Company to enjoin the construction of a dam in the New River. The Federal Power Commission had required the Power Company to take a standard form of license authorizing it to build the dam as an obstruction to a navigable stream, which license the Power Company had refused to take for the reason, in part, that it objected to Section 14 of the license, which provided for the acquisition of the dam at the end of fifty years. On this contention the court said (311 U. S. 377, at 421):

> "The petitioner suggests that consideration of the validity of §14, the acquisition clause, and the license conditions based upon its language are properly to be deferred until the United States undertakes to claim the right to purchase the project on the license terms fifty years after its issuance. Assuming that the mere acceptance of a license would not later bar the objection of unconstitutional conditions, even when accompanied by a specific agreement to abide by the statute and license, we conclude that here the requirements of §14 so vitally affect the establishment and financing of respondent's project as to require a determination of their validity before finally adjudging the issue of injunction."

In *Euclid* v. *Ambler Co.,* 272 U. S. 365, 47 Sup. Ct. 114, 71 L. Ed. 303 (1926), the case arose on a motion to dismiss a bill brought to enjoin the enforcement of a zoning ordinance, on the ground, among others, that "because complainant (appellee) had made no effort to obtain a building permit or apply to the zoning board of appeals for relief as it might have done under the terms of the ordinance, the suit was premature." On this point the court said (272 U. S. 365, 386):

> "The motion was properly overruled. The effect of the allegations of the bill is that the ordinance of its own force operates greatly to reduce the value of appellee's lands and destroy their marketability for industrial, commercial and residential uses; and the attack is directed, not against any specific provision or provisions, but against the ordinance as an entirety. Assuming the premises, the existence and maintenance of the ordinance, in effect, constitutes a present invasion of appellee's property rights and a threat to continue it. Under these circumstances, the equitable jurisdiction is clear. See *Terrace* v. *Thompson,* 263 U. S. 197, 215; *Pierce* v. *Society of Sisters,* 268 U. S. 510, 535."

The court again (272 U. S. 395) referred to the case as a case in which "the equitable remedy of injunction is sought * * * not upon the ground of a present infringement or denial of a specific right or of a particular injury in process of actual execution but on the broad ground" of "the *mere existence* and threatened enforcement of the ordinance * * *".

In *Pierce* v. *Society of Sisters,* 268 U. S. 510, 45 Sup. Ct. 571, 69 L. Ed. 1070 (1924), the Society of Sisters sought an injunction restraining the Governor and other officials of Oregon from threatening to enforce a school law requiring parents to send children to primary schools of the state. The suit was brought before the effective date of the Act. The plaintiff claimed injury arising from the reluctance of parents to make commitments to send their children to the plaintiff's school in view of the existence and possible future enforcement of the Act. The Court said, 268 U. S. 536:

> "The suits were not premature. The injury to appellees was present and very real, not a mere possibility in the remote future".

See also

*Terrace* v. *Thompson,* 263 U. S. 197, 44 Sup. Ct. 15, 68 L. Ed. 255 (1923);

*Aetna Life Insurance Company of Hartford* v. *Haworth,* 300 U. S. 227, 57 Sup. Ct. 461, 81 L. Ed. 617 (1937);

*Currin* v. *Wallace,* 306 U. S. 1, 59 Sup. Ct. 379, 83 L. Ed. 441 (1939);

*Gully* v. *Interstate Natural Gas Company,* 82 F. (2d) 145 (C. C. A. 5th, 1936);

*Davis* v. *American Foundry Equipment Company,* 94 F. (2d) 441 (C. C. A. 7th, 1938);

*Fidelity National Bank* v. *Swope,* 274 U. S. 123, 47 Sup. Ct. 511, 71 L. Ed. 959 (1927);

*Black* v. *Little,* 8 F. Supp. 867 (E. D. Mich., 1934);

*N. Y. and Puerto Rico S. S. Company et al.* v. *U. S.,* 32 F. Supp. 538 (E. D., N. Y. 1940);

*Dewey & Almy Chemical Co.* v. *American Anode,* 137 F. (2d) 68 (C. C. A. 3rd, 1943), at 69. Cert. denied, 320 U. S. 761;

*Maryland Casualty* v. *Pacific Coal & Oil Co.,* 312 U. S. 270, 61 Sup. Ct. 510, 85 L. Ed. 826 (1941);

*Work* v. *Louisiana,* 269 U. S. 250, 46 Sup. Ct. 92, 70 L. Ed. 259 (1925).

In summary, the plaintiff is entitled, in this suit for a declaratory judgment, to be relieved from the "threat of official action resulting from his relation to a governmental agency" (30 Fed. Supp. 995, at 1008). It does not have to plead or show the possibility of irreparable damage from the threatened action. *Nashville, C. & St. Louis Ry. Co.* v. *Wallace, supra,* p. 59. It does not have to show that it is under any "immediate and impending danger". It does not have to "await the pleasure of the District Attorney" (or the Board of Governors) "who may never begin his suit". 30 Fed. Supp. 995, at 1008.

> "The administrative order * * * is reviewable and it does not cease to be so merely because it is not certain whether the Commission" (or the Board of Governors) "will institute proceedings to enforce the penalty incurred under its regulations for noncompliance" (*Columbia Broadcasting System* v. *U. S.,* 316 U. S. 407, at 417).

*This proceeding is timely. It is not premature.*

* * * * * *

As we have shown, the contention that the suit is premature is untenable. And, to say the least, it is not meritorious. Confronted with this strange, arbitrary and outrageous condition, pregnant with present and future damage, with absolutely nothing it can do to alter the situation or to have a determination of its rights except through the medium of a declaratory judgment, plaintiff bank seeks a determination of its rights as a stockholder in the defendant Reserve Bank. Is it going to lose its stock or is it not? One would think that the Reserve Bank would be equally as anxious to know whether or not this condition affecting its stock—a condition peculiar to this single stockholder and not applicable to any other stockholder in the bank—was a valid condition. What has the defendant Reserve Bank to gain by contriving to postpone a determination of this important question? How are its interests in any way prejudiced by an immediate solution of the question presented? One would naturally think

that it would seize the first opportunity to *assist* the plaintiff, as one of its stockholders, to clarify its position, instead of exercising all of its ingenuity to avoid a determination on the merits. The Reserve Bank is not a private litigant. It is a public institution. It is a servant of the plaintiff—not the plaintiff's master. It owes a duty to the plaintiff to aid the plaintiff rather than to hinder it.

## VII.

**The claim of the Board of Governors and of the defendant Reserve Bank of a right to deprive the plaintiff of its stock in the defendant Reserve Bank by an enforcement of condition No. 4 is an adverse claim within the purview of Section 738 of the Code of Civil Procedure of California, the existence of which adverse claim the Federal Court in this case can ascertain and declare in a declaratory judgment proceeding.**

This is an additional and sufficient ground for giving relief to the plaintiff. In Paragraph VIII of the complaint (*supra,* p. 4), it is alleged that:

> "Plaintiff further asserts that said void condition No. 4 is a cloud upon the title to the said shares of defendant, the Federal Reserve Bank of San Francisco, owned by plaintiff".

Section 738 of the California Code of Civil Procedure provides as follows:

> "An action may be brought by any person against another who claims an estate or interest in real or personal property, adverse to him, for the purpose of determining such adverse claim; * * *."

Under this section an action may be brought to remove a cloud on title—even where the invalidity of the document constituting the cloud is apparent on the face thereof.

*Dranga* v. *Rowe,* 127 Cal. 506, 59 Pac. 944 (Sup. Ct., Cal. 1900); *Kittle* v. *Bellegarde,* 86 Cal. 556, 25 Pac. 55 (Sup.

Ct., Cal. 1890); *Miller* v. *Price,* 103 Cal. App. 650, 284 Pac. 1035 (Dist. Ct. of App. 3d Dist. Cal. 1930). 25 California Law Review, 565 at 570 (1937).

The words "personal property" as used in Section 738 have been held to include shares of stock, and in *Barr* v. *Smith,* 201 Cal. 87, 255 Pac. 827, (Sup. Ct., Cal. 1927) the court so held in an action to quiet title. In this connection it should be noted that in *Jellenick* v. *Huron Copper Mining Co.,* 177 U. S. 1, 20 Sup. Ct. 559, 44 L. Ed. 647 (1899), the Supreme Court of the United States held that the words "personal property" as used in 28 U. S. C. A. Sec. 118, also apply to shares of stock, and that an action could be maintained under that section to remove a cloud upon the title to such shares.

In support of its holding that the suit "may not properly be maintained as one to remove a cloud upon the title of plaintiff's stock in the Reserve Bank" (R., p. 164), the District Court said:

> "Finally, it is my opinion that there is no merit in plaintiff's contention that condition No. 4 constitutes a cloud upon the title to plaintiff's stock in the Reserve Bank or an adverse claim affecting the same, in the nature of a cloud, the existence of which the Court has power to remove. Plaintiff's shares in the Reserve Bank are a mere incident to its membership therein. This stock is non-transferable, non-negotiable and has no 'market value'. Title to this stock must, under the law, remain in plaintiff bank so long as it is a member bank and, when and if that status is forfeited, the title to the stock is likewise forfeited. None of the defendants claims an estate or interest in the stock adverse to plaintiff. Clearly a case is not presented which is governed by section 738 of the California Code of Civil Procedure. The suit sounds *in personam* against the Board of Governors for alleged abuse of discretion, not *in rem.*"

**a. Plaintiff's shares in the Reserve Bank are more than a "mere incident to its membership therein", but whether or not a mere incident they are property of the kind with respect to which the plaintiff is entitled to have an adverse claim adjudicated.**

True it is that in order to be a member of the Federal Reserve System, the only qualification required by law is that the plaintiff bank shall become a stockholder in the defendant Reserve Bank. But being a stockholder in the defendant bank, it has most, if not all, of the customary rights of the stockholder. As such stockholder, plaintiff has the right to vote for directors of the defendant bank. It has the right to receive mandatory dividends on its stock. It has the right upon a surrender of its shares to receive back the subscription price paid for its shares, less its debts to the Reserve Bank. Stock in a Reserve Bank is subject to double liability (Title 12, Sec. 502). Non-voting stock may be held by the United States and sold to others. Any stock held by the public is transferable on the books of the bank (Title 12, Sec. 283), and there are no provisions for the cancellation of such stock. The Board of Governors has express authority to promulgate rules and regulations governing the transfer of stock (Title 12, Sec. 286).

We respectfully submit that there is no merit in the District Court's view that the plaintiff's stock in the defendant Reserve Bank is a mere incident. We do not see that that has any bearing upon the matter whatsoever. Whether a mere incident or not, it is a very valuable piece of personal property. It is stock—very valuable stock. Its continued ownership—loss of which is threatened under condition No. 4—is of the utmost importance. And as such the plaintiff has a right to have a determination of the validity of adverse claims affecting the same.

**b. The District Court next states that "this stock is non-transferable, non-negotiable and has no 'market value' ".**

We respectfully submit that these facts have no bearing on the situation whatsoever. *The California Code imposes no such limitation.* The code applies to an adverse claim to *any* property. Whether the property of the plaintiff affected by an adverse claim of the defendant is transferable or negotiable or has "market" value is, we submit, of no consequence. It, of course, is of consequence that the

property in question has actual value, and, obviously this property has a great deal of actual value. It has not only the value that the plaintiff paid for it, it has value as an earner of dividends and it has very great value, to quote the brief of the defendant Reserve Bank in the court below, because of the resultant membership in the Reserve Bank which carries with it "a certain prestige and many practical advantages". Among these are the practical advantages of the position, which results from the ownership of that stock, of being an insured bank.

**c. The District Court next states that "none of the defendants claims an estate of interest in the stock adverse to the plaintiff". On the contrary, we submit, the claim of the defendant Reserve Bank of the right to cancel the defendant's stock on its records in the enforcement of an order made by the Board of Governors directing the plaintiff to surrender its stock is an adverse claim affecting the plaintiff's property within the purview of the California statute.**

We respectfully submit that the District Court entirely misapprehended the scope and extent of claims affecting property which come within the description of "adverse" claims under the California Code, or which, under that code, constitute what are generally spoken of as clouds on title. For a claim to constitute an adverse claim or to constitute a cloud on title it is not at all essential that the defendant should assert a legal or equitable interest in the plaintiff's property by virtue of the claim. The California courts have not given the phrase "an estate of interest" appearing in Sec. 738 of the California Code, the narrow construction given to it by the District Court in this case.

In *Castro* v. *Barry,* 79 Cal. 443, 21 Pac. 946 (Sup. Ct., Cal. 1889), the Court laid down the law respecting Sec. 738 of the Code as follows (p. 947):

> "Nor is it necessary that the adverse claim should be of any particular character. As said by Baldwin, J., delivering the opinion in *Head* v. *Fordyce,* 17 Cal. 151, the statute 'does not confine the remedy to the case of an adverse claimant setting up a legal title

> or even an equitable title; but *the act intended to embrace every description of claim whereby the plaintiff might be deprived of the property,* or its title clouded, *or its value depreciated,* or whereby the plaintiff might be incommoded or damnified by the assertion of an outstanding title already held or to grow out of the adverse pretention'. See, also, *Horn* v. *Jones,* 28 Cal. 204; *Joyce* v. *McAvoy,* 31 Cal. 287, 288. *And the rule may be even more broadly stated, viz., that the action may be maintained by the owner of property to determine any adverse claim whatever,* for, if the defendant, by his answer, disclaims all interest whatever, judgment may, nevertheless, be entered against him, though in such case it must be without costs."

Accord, see *Hamilton* v. *Elvidge,* 132 Cal. App. 21, 22 P. (2d) 239 (D. C. of App., First Dist. Cal. (1933), *Welsh* v. *Plumas County,* 22 Pac. 254 (Sup. Ct. Cal. 1889).

*Los Angeles* v. *Los Angeles Water Company,* 177 U. S. 558, 20 Sup. Ct. 736, 44 L. Ed. 886 (1900), at 580 is in point. That case involved the validity of an ordinance of the city establishing water rates below those named in the original grant to the Water Company. One of the contentions of the defendant city was that the ordinance, if invalid, was void on its face and was therefore "no cloud on the company's title" to its original franchise. The Supreme Court sustained the determination of the lower court to the effect that the invalid ordinance constituted a cloud on the Water Company's title to its original franchise. Obviously here was no case where the defendant, the city, was asserting an "estate of interest" in the plaintiff's property. An invalid ordinance constituted the cloud. In the instant case, another type of legislation, an invalid condition, constitutes the cloud.

> Semble, *Spring Valley Water-Works* v. *Bartlett,* 16 Fed. 615 (Cir. C. D. Cal., 1883).

In *Rector, etc., of St. Stephens Protestant Episcopal Church* v. *Rector, etc., of Church of the Transfiguration,* 114 N. Y. Supp. 623 (App. Div. First Dept., 1909), affd., 201 N. Y. 1 (1911), the plaintiff had acquired property from the de-

fendant by a deed which contained a restrictive clause providing that the grantee, his heirs and assigns, should not thereafter utilize the property for any purpose other than church purposes. There was no adjoining property of any kind belonging to the defendant for the benefit of which the restrictive covenant had been imposed. The court held that the lack of any enforceable interest in the defendant was not a bar to the action and granted the relief required, saying (114 N. Y. Supp. 623, at 629):

> "It is also objected that no equitable relief should be awarded to the plaintiff in this action because, even if the covenant is not void upon its face, its invalidity arising from the lack of enforceable interest on the part of defendant will necessarily appear in any proceeding taken to enforce the covenant. It is doubtful if this is strictly true, but, even if it is, it is not necessarily an answer to plaintiff's demand."

It would be difficult to think of a claim more adversely affecting plaintiff's property than the claim of a right in the defendant to take that property entirely away from the plaintiff and to destroy the plaintiff's ownership therein. In the language quoted from *Castro* v. *Barry, supra,* an "adverse claim" embraces "every description of claim whereby the plaintiff might be deprived of the property * * * or its value depreciated * * *". What could be more adverse to the plaintiff? What could constitute more of a cloud upon its property? If in the *Los Angeles Water Company* case, 177 U. S. 558, *supra,* the passage by the city of an ordinance reducing the rates in the Water Company's franchise constituted, as was so held by the court, a cloud upon the title of the Water Company to its franchise, *a fortiori* a claim by the City of Los Angeles of a right to entirely cancel the Water Company's franchise would have constituted a cloud on its title. That is the nature of the right which counsel for the Reserve Bank in his argument in the District Court admitted that the Reserve Bank would exercise. It would cancel the stock of the plaintiff (R., p. 114).

**(d) The District Court next states that the "suit sounds *in personam* * * * not *in rem*".**

We respectfully submit that the fact that the suit would appear to be a suit *in personam* is of no consequence. Section 738 of the California Code of Civil Procedure expressly contemplates that the suit should be a suit *in personam.* It states: "An action may be brought by any person against another * * *" (*supra,* p. 69).

In fact it would appear that most (if not all) of the suits which have been brought under Section 738 of the California Code of Civil Procedure have been in the nature of *in personam* proceedings.

See:

> *Marra* v. *Aetna Construction Company,* 15 Cal. (2d) 375, 101 P. (2d) 490, (Sup. Ct. Cal. 1940), *infra.*

In 51 Corpus Juris 141 the nature of a proceeding required to remove a cloud on title is summarized as follows:

> "The fundamental doctrine of equity, as originally administered, that every action in equity is purely an action *in personam,* applies to actions to remove clouds from title, unless abrogated by statute. But it is generally held that actions under statutes providing for the determination of adverse claims are in the nature of proceedings *in rem,* or quasi *in rem.* Some authorities have held that the character of the statutory action is determined by the nature of the process; that is, where personal service can be made, the action is *in personam* as well as *in rem,* but where service can be obtained only by publication, the action is *in rem.*"

In the present case, the suit was begun by personal service against the defendant Reserve Bank, and therefore, we do not have to bother with the question as to whether the action as to that bank is *in rem* or *in personam.*

We therefore respectfully submit that the District Court fell into error in the final reason which it assigned on this aspect of the case, to-wit, that "the suit sounds *in personam* * * * and not *in rem* * * *".

**(e) A declaratory judgment proceeding is appropriate for the determination of an adverse claim.**

From the language of Section 738 of the California Code of Civil Procedure, it would seem that it contemplated a declaratory judgment as an appropriate way of dealing with the adverse claim. The statute (*supra,* p. 69) reads as follows:

> "An action may be brought by any person against another * * * for the purpose of *determining* such adverse claim;"

The combination of the declaratory judgment and a proceeding to quiet title is specifically recognized by the California court.

In *Marra* v. *Aetna Construction Co.,* 15 Cal. (2d) 375, 101 P. (2d) 490 (Sup. Ct. Cal., 1940), plaintiff brought an action to obtain a declaration that his real property was free of certain building restrictions. The defendant was the owner of adjoining property. The court said, among other things (101 P. (2d) 490, at 492):

> "However, since the decision of this court in *Hess* v. *Country Club Park,* 213 Cal. 613, 2 P. 2d 782, it has been settled that an owner may test the enforceability of covenants or servitudes asserted against his property *in a suit for declaratory relief* and to quiet title. He is not required to violate the restrictions at the risk of suffering the penalties which might result from such a breach in order to ascertain his legal rights. See 50 Harv. L. Rev. 171, 217; *Osius* v. *Barton,* 109 Fla. 556, 147 So. 862, 88 A. L. R. 394, 405."

Accord *Moe* v. *Gier,* 116 Cal. App. 403, 2 P. (2d) 852 (Dist. Ct. of App. Cal. 1931).

See also:

*Wickliffe* v. *Owings,* 17 How. 47, 58 Sup. Ct. 15 L. Ed. 44 (1854);
*Williams* v. *Atlantic Coast Line R. R.,* 17 F. (2d) 17 (C. C. A. 4th, 1927); and
*Wolf* v. *Gall,* 174 Cal. 140, 162 Pac. 115 (Sup. Ct. Cal., 1916).

**(f) In states where there is a statute providing for the removal of adverse claims, even where such statute clearly enlarges the jurisdiction theretofore possessed by the courts with respect to the removal of such claims, the courts of the United States will give effect to the local statute.**

In *Louisville & Nashville R. R. Co.* v. *Western Union Telegraph Company,* 234 U. S. 369, 34 Sup. Ct. 810, 58 L. Ed. 356 (1914), there was a Mississippi statute, quite similar to Section 738 of the California Code of Civil Procedure. In this case by a bill in equity the plaintiff sought the annulment of three judgments given by a condemnation court, as constituting a cloud upon a title to his property. The main defense was that the bill would not lie, in that the condemnation judgments, if void at all, were void on their face. The Court first found that under the Mississippi statute the state courts would have removed the cloud notwithstanding that the invalidity was apparent on the face of the alleged cloud, and went on to say (234 U. S. 369, at 376):

> "We conclude that the provision in Sec. 57 of the Judicial Code, respecting suits to remove clouds from title, was intended to embrace, and does embrace, suits of that nature when founded upon the remedial statutes of the several States, as well as when resting upon established usages and practice in equity."

See *More* v. *Steinbach,* 127 U. S. 70, 8 Sup. Ct. 1067, 32 L. Ed. 51 (1887); *Smith Oyster Co.* v. *Darbee, etc., Co.,* 149 Fed. 555 (C. C. N. D. Cal. 1906); *Devine* v. *Los Angeles,* 202 U. S. 313, 26 Sup. Ct. 652, 50 L. Ed. 1046 (1906).

**(g) No contention can be made that a proceeding to remove an adverse claim is premature.**

A plaintiff confronted with an adverse claim affecting his property is entitled to have his rights determined at any time, irrespective of whether he is confronted with any threat of action, immediate or otherwise, by the holder of the adverse claim.

> *Marra* v. *Aetna Construction Company,* 15 Cal. 2nd 375, 101 Pac. (2d) 490 (Sup. Ct. Cal. 1940), *supra.*

In fact it is well established that a plaintiff can bring a suit to prevent the casting of a cloud on the title to his property as well as to remove an existing cloud. 44 Am. Jur. Sec. 17.

See also:

> *Carroll* v. *Safford,* 3 How. 440, 44 Sup. Ct. 500, 11 L. Ed. 671 (1845);
> *Allen* v. *Hanks,* 136 U. S. 300, 10 Sup. Ct. 961, 34 L. Ed. 414 (1890);
> *Lane* v. *Watts,* 234 U. S. 525, 34 Sup. Ct. 965, 58 L. Ed. 1440 (1914); and
> *Title and Document Restoration Company* v. *Kerrigan,* 150 Cal. 289, 88 Pac. 356 (1906).

## VIII.

**Henry F. Grady, as Federal Reserve Agent, is a proper, although not an indispensable, party defendant.**

The statute (Sec. 305, Title 12) provides, as above stated (p. 8) that one of the class C directors of a Reserve Bank shall be designated as Chairman of the Board of Directors of the Federal Reserve Bank and as "the Federal Reserve Agent" and that "he * * * *shall act as its (the Board's) official representative for the performance of the functions conferred upon it by this chapter.*"

The Board of Governors is a body that by its very nature can only act through representatives or agents. The statute, therefore, makes it mandatory that whenever it acts within a particular district, it may only employ or utilize the Federal Reserve Agent as its representative. The statute makes it clear that such employment extends to every act or function which the Board can perform. It may not select the Federal Reserve Agent as its representative with respect to certain functions, and delegate other functions to some other agent, such, as for example, the local Federal Reserve Bank.

The Board of Governors has conferred numerous functions on the Federal Reserve Agent in connection with a state bank's membership in the system. Part 208 of Chapter II of Title 12 of the Code of Federal Regulations contains these regulations of the Board with respect to the membership of state banking institutions in the Federal Reserve System.

It would seem from these regulations that the channel of approach through which a state bank may deal with the Board in applying for membership and in withdrawing from membership is by the Board's own regulations confined to the Federal Reserve Agent. Through him the Board is acting within the district in the very matter with which this litigation is concerned.

In the event of the attempted enforcement by the Board of Governors of condition No. 4, embraced in an invalid order to the plaintiff bank to "surrender its stock" in the defendant Reserve Bank and the plaintiff's disobedience of this invalid order, it may well be that the Board of Governors would attempt to do something in California against the plaintiff. We do not need to speculate what course of action it may devise. We have no doubt that the Reserve Agent intends to do whatever he may be required to do. We so allege. And on the motion to dismiss the allegation is admitted. Whatever the Board may do in California, it is required by law to do through the Federal Reserve Agent. It is consequently appropriate that he should be a party defendant to this suit and be heard on

the questions involved and that the plaintiff should have a declaration of rights as to him.

## In Conclusion.

It is incredible that the people of the United States, who are still the source of all authority, or their Congress, have or ever had any intention of vesting any Federal Agency with the power to single out and name a person or corporation as unfit or disqualified to be associated with others in a given lawful human activity, except as a punishment after trial and conviction of some offense known to the law; nor can it be believed that so-called subalterns shall be immune from those processes of law and restraints to which all persons are subject, because these so-called subalterns act or attempt to act pursuant to and upon the authority of the void and unconscionable orders of their superiors and especially when such acts operate to deprive other citizens of rights guaranteed them under the Constitution.

The order of the District Court dismissing the complaint as against the defendant Federal Reserve Bank and as against the defendant Henry F. Grady, the Federal Reserve Agent, should be reversed.

Respectfully submitted,

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